



OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: December 23, 1999

REPLY TO

ATTN OF: Inspector General

SUBJECT: Final Reports Related to Non-Tax Delinquent Debt

TO: Chairman

This memorandum conveys a series of reports prepared by the firm of Ernst & Young LLP under the auspices of the Office of Inspector General (OIG). This work was initially undertaken in order to address concerns raised by the Subcommittee on Government Management, Information and Technology, Committee on Government Reform and Oversight related to the government-wide collectibility of non-tax delinquent debt. The reports are listed below.

- 1. **OBSERVATIONS AND RECOMMENDATIONS ON FCC'S REPORT ON RECEIVABLES DUE FROM THE PUBLIC:** A document providing observations and seven recommendations and one observation for improving the accuracy of the FCC's "Report on Receivables Due from the Public". The Managing Director responding for himself, Wireless Telecommunications Bureau and the General Counsel concurred with each recommendation and the one observation. His response in entirety is included as an Attachment to the series of reports.
- 2. **DEBT MANAGEMENT OBSERVATIONS AND RECOMMENDATIONS:** Eleven recommendations developed in response to findings associated with the completion of the PCIE Review Guide. The Managing Director responding for himself, Wireless Telecommunications Bureau and the General Counsel concurred with ten of the eleven recommendations. With regard to implementing additional "front-end" controls to determine prospective applicant's ability to repay the loan, the Managing Director indicated in part that the "issue remains to be resolved." At this point in time, I consider this a "non-concurrence."

- 3. OVERVIEW OF DELINQUENT DEBT AND DEBT MANAGEMENT
ACTIVITIES: An overview of the FCC's Spectrum Auction installment loan program. Includes criteria used in classifying related loan amounts as non-tax delinquent debt, estimate as to the amount of this debt, front-end control analysis and current debt collection procedures and effort to reduce potential losses.
- 4. OVERVIEW OF APPROACHES FOR DETERMINING COLLECTIBILITY OF SPECTRUM AUCTION LOAN PORTFOLIO: Recommended approaches for determining collectibility of the non-tax delinquent debt related to Spectrum Auction program.
- 5. PERFORMANCE REVIEW GUIDE: Contains relevant portions of the Performance Review Guide published by the Treasury Department OIG related to President's Council on Integrity and Efficiency (PCIE) Review of Non-Tax Delinquent Debt.

The execution of this project resulted in eighteen formal recommendations of which management has concurred with seventeen. We believe that this commitment on the part of the FCC to address deficiencies in the auction loan program will result in more accurate computation and reporting of loan balances. This effort, when taken in conjunction with improved loan servicing and debt collection practices, as recommended by this office, will result in overall program improvements. These improvement in internal controls, consistency in processing standard, and compliance with Federal laws and regulations will result in better protection of the financial assets of the Federal government.

If you have any comments or questions, please contact me on 418-0476.



H. Walker Feaster III

Attachments

cc: Chief of Staff
Managing Director
Chief, Wireless Telecommunications Bureau
Chief Financial Officer

December 20, 1999

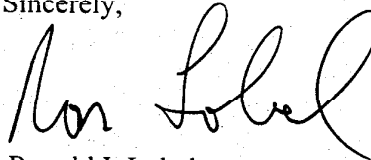
Mr. Walker Feaster
Inspector General
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Reports on FCC Debt Management Practices

Dear Mr. Feaster:

In connection with our consulting services conducted for the Federal Communications Commission Office of Inspector General, under Purchase Order P995402039, we are pleased to submit 10 copies each of our five reports related to the FCC's debt management practices. It was a pleasure to serve the FCC on this important project. Please feel free to call Dennis Stout at 202-327-7316 or me at 202-327-7263 if we can be of any additional assistance.

Sincerely,



Ronald I. Lobel
Partner

Enclosures



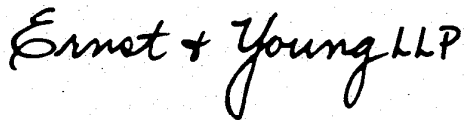
OFFICE OF INSPECTOR GENERAL
FEDERAL COMMUNICATIONS COMMISSION

OBSERVATIONS AND RECOMMENDATIONS
ON FCC'S REPORT ON RECEIVABLES
DUE FROM THE PUBLIC

JUNE 18, 1999

Office of Inspector General
Federal Communications Commission
445 12th St., S.W.
Washington, D.C. 20554

This document is provided as part of our consulting services conducted for the Federal Communications Commission ("FCC" or "Commission") Office of Inspector General ("OIG") under purchase order P995402039. Pursuant to our statement of work, this document provides observations and recommendations for improving the accuracy of the FCC's "*Report on Receivable Due From the Public*". We accept no responsibility to update or revise this document for events that occur or new information that becomes available subsequent to the date of this document.

A handwritten signature in black ink that reads 'Ernst & Young LLP' in a cursive, script font.

June 18, 1999

TABLE OF CONTENTS

Background	1
Overall Comments: FCC Report on Receivables Due From the Public.....	2
Part 1, Section A: Receivables and Collections.....	3
Part 1, Section B: Delinquent Debt by Age	5
Part 2, Section A: Delinquent Debt 180 Days or Less	7
Part 2, Section B: Delinquent Debt 181 Days and Over.....	8
Part 2, Section C: Collections	9
Part 2, Section D: Debt Disposition	10
Part 3: Footnotes.....	11

BACKGROUND

This document is provided as part of our consulting services conducted for the Federal Communications Commission ("FCC" or "Commission") Office of Inspector General ("OIG") under purchase order P995402039. Pursuant to our statement of work, this document provides observations and recommendations for improving the accuracy of the FCC's "Report on Receivables Due From the Public".

Our consulting services were performed to assist the FCC OIG in its assessment of the FCC's debt management practices. Our work was conducted in accordance with consulting standards of the American Institute of Certified Public Accountants and did not constitute an audit or any other form of assurance on any financial information or debt management practices of the FCC. In performing this task, interviews were conducted and documentation researched to obtain a general understanding of the FCC's debt collection procedures. Various relevant regulatory guidance was also reviewed. This project is one of several consulting projects we are performing for the FCC on a variety of debt portfolio related matters.

As requested by the FCC OIG, this document focuses only on the FCC's Spectrum Auction installment loan program. When a reference is made to FCC "debt" and/or "loans", it is meant to refer to the receivables resulting from the auction installment loan program. This document assumes the FCC has a secured interest in the license associated with an installment loan and that upon default, a new license related to the same service and market of the canceled license can be subsequently auctioned with the proceeds raised applied to the outstanding loan amount of the defaulted debtor.

The Department of Treasury ("Treasury") uses the "Report on Receivables Due From the Public" ("SF 220-9") as its only comprehensive means for periodically collecting data on the status and condition of the Federal Government's non-tax debt portfolio, in accordance with the requirements of the Debt Collection Act of 1982 and the Debt Collection Improvement Act of 1996 ("DCIA"). The information contained in the SF 220-9 is disseminated to the Congress, the Office of Management and Budget, agency Chief Financial Officers, the Federal Credit Policy

Working Group, other officials and representatives of Federal and state organizations, private sector organizations, and the public.

Treasury guidance on the SF 220-9 states that the SF 220-9 is no longer attempting to be an accounting report; that need is being addressed through agencies' annual financial statements. Rather, Treasury is attempting to make the SF 220-9 more of a management report which informs Federal decision makers of the gross book value of the debts held by the Federal Government and the actions taken to enforce collection. This gross book value amount is not the same amount reported on agency financial statements, which is presented in accordance with Federal Credit Reform and other regulations and guidance, i.e., at net of allowances for credit losses.

The SF 220-9 consists of three parts: (1) Status of Receivables, (2) Debt Management Tool and Technique Performance Data, and (3) Footnotes. The SF 220-9 is due to the Treasury's Financial Management Service ("FMS") by the end of the 30th day of the month following the close of each of the first three quarters. The report is now submitted by agencies to FMS via the Internet, rather than the existing GOALS system.

OVERALL COMMENTS: FCC REPORT ON RECEIVABLES DUE FROM THE PUBLIC

The FCC prepares its SF 220-9 using information from the Nortridge Loan Tracking System for loans not in bankruptcy, and from spreadsheets produced by FCC officials for loans in bankruptcy. The FCC's accounting staff preparing the SF 220-9 must be provided updated bankruptcy information at the end of each quarter. The latest SF 220-9 (March 31, 1999) did not account for two bankrupt borrowers who were in bankruptcy at that time, MagnaCom and UrbanCom, with a combined outstanding principal balance of over \$100 million.

The Nortridge Loan Tracking System should be updated regularly to reflect current balances of borrowers in bankruptcy. There should also be an identifier within Nortridge to track the current status of the loan (i.e., bankruptcy? yes/no). This would allow accounting staff to print bankruptcy reports straight from Nortridge and eliminate the need to draw information from two different sources for the SF 220-9.

PART 1, SECTION A: RECEIVABLES AND COLLECTIONS

This section of the SF 220-9 shows the current beginning fiscal year balance of all receivables and the cumulative activity during the fiscal year as of the end of the quarterly reporting period for new receivables, accruals, collections, adjustments, amounts written-off, and the ending balance at the end of the reporting period. Additionally, receivables are classified as foreign/sovereign, state and local government, rescheduled, and interest and late charges.

FCC Report on Receivables Due From the Public; March 31, 1999 (Unaudited)

Part 1 – Status of Receivables		
	Number	Dollars
Section A		
Receivables and Collections		
1 Beginning FY Balance	1,379	\$8,876,259,402
2 New Receivables (+)	0	223,938,072
3 Accruals (+)		0
4 Collections on Receivables (-)		0
(A) At Agency (-)		0
(B) At Third Party (-)		0
(C) Asset Sales (-)		0
(D) Other (-)		0
5 Adjustments (+ or -)	0	-759,999
(A) Reclassified/Adjusted Amounts (+ or -)		-759,999
(B) Adjustments Due to Sale of Assets (+ or -)		0
(C) Consolidations (+ or -)		0
6 Amounts Written Off (-)	0	0
7 Ending Balance	0	\$9,099,437,475
(A) Foreign/Sovereign (+)	0	0
(B) State and Local Government (+)	0	0
8 Rescheduled Debt		
(A) Delinquent (+)	0	0
(B) Non-Delinquent (+)	0	0
9 Interest & Late Charges (+)		\$1,012,127,414

Recommendations

Accruals: According to Treasury, Accruals, Line 3, should include all *earned* interest and late charges accrued during the current fiscal year. The FCC currently is not reporting any accruals on the SF 220-9. The FCC should include the amount of

assessed late fees and earned interest on the SF 220-9 in the future. Note that accruals and late fees cease when a debtor enters bankruptcy and there are exceptions to rules governing the application of late fees.

Adjustments: Adjustments track the number and dollar amount of changes to receivables during the fiscal year due to reclassifications or adjustments, acquisition of property, estimated losses on acquired property, or consolidations. There are several examples of adjustments the FCC should be able to report.

The FCC will need to track adjustments which result from its current loan balance recalculation efforts. The FCC, with contractor assistance, is in the process of sending confirmation letters to borrowers to confirm loan balances and terms. Loan balances have been recalculated separately from the Nortridge Loan Tracking System. Accordingly, the resulting loan balance from the confirmation process may vary from what is currently reported in Nortridge and on the Schedule of Receivables. As the confirmation process is completed, the differences between the balances previously reported on the SF 220-9 and the confirmed, recalculated balances should be reflected here.

Confirmation letters have not been sent to borrowers in default or in bankruptcy. Adjustments should be reported on these loan balances as litigation is completed or as proceeds from auctioned licenses are applied to the outstanding debt of defaulted licensees. FASAB 2 requires when property is transferred from borrowers to a Federal credit program, through foreclosure or other means, in partial or full settlement of post-1991 direct loans, the property is recognized as an asset at the present value of its estimated future net cash inflows discounted at the original discount rate. Accordingly, the FCC should establish accounting policy to handle the valuation of defaulted debt and the estimated loss should be reported as an adjustment of the SF 220-9.

PART 1, SECTION B: DELINQUENT DEBT BY AGE

This section of the SF 220-9 contains an aging schedule and classifies delinquent debt by Commercial, Consumer and Foreign/Sovereign categories.

FCC Report on Receivables Due From the Public; March 31, 1999 (Unaudited)

Part 1 – Status of Receivables		
	Number	Dollars
Section B		
Delinquent Debt by Age		
1 Total Delinquencies (+)	747	\$7,136,636,130
(A) 1 – 90 Days (+)		7,751,852
(B) 91 – 180 Days (+)		11,109,520
(C) 181 – 365 Days (+)		14,701,857
(D) 1 – 2 Years (+)		7,099,029,164
(E) 2 – 6 Years (+)		3,943,737
(F) Over 10 Years (+)		0
2 Commercial (+)	747	7,136,536,130
3 Consumer (+)	0	0
4 Foreign/Sovereign Debt (+)	0	0

Recommendations

Treasury instructions on completing this section of the report state, “receivables are recorded as delinquent if not paid by the payment due date unless terms of the contract or agreement provide otherwise. If the contract or agreement provides for a ‘grace’ period, then the receivable is not considered delinquent until that period expires without payment. If a ‘grace’ period expires without payment, then the receivable is aged from the original payment due date or date of notification.”

The current FCC Spectrum Auction installment loan program rules governing installment payments that are past due are as follows:

- Licensees that do not make an installment payment on or before a due date are automatically granted a 90-day grace period (“non-delinquency period”) and assessed a late fee equal to 5 percent of the missed installment payment.

- If remittance of the missed installment payment and the 5 percent late fee is not made on or before expiration of the non-delinquency period, a second 90-day period (“grace period”) is automatically granted and an additional late fee equal to 10 percent of the missed installment payment is assessed.
- Licensees are not required to make an application to the Commission to receive the non-delinquency period or the grace period.
- Any licensee that becomes more than 180 days past due on an installment payment shall be in default and the license shall automatically cancel without further action by the Commission.

There are a few exceptions to the above rules that would cause a loan more than 180 days past due not to be in default (examples: pending waiver request, error in recognizing payment). However, based on discussions with FCC management, since FCC Spectrum Auction rules provide for two automatic 90-day grace periods, an installment loan would *generally* be considered “delinquent” on the 181st day after the payment due date provided that no waiver has been timely requested by the borrower or granted by the FCC.

Accordingly, on the aging schedule submitted on the SF 220-9, there should be no loans reported as being 1 – 180 days delinquent. Treasury stipulates that a loan is considered “delinquent” after the end of any “grace” period (180 days), but the receivable is aged from the original payment due date. For example, if a licensee does not make an installment payment on a loan for 181 days, this loan should not appear on the aging schedule until the 181st day. However, the loan will fall in the category of 181 days delinquent, not 1 day.

In addition to these changes to the delinquency schedule, the principal amounts reported should be consistent. For loans that are in bankruptcy and delinquent, the entire outstanding principal balance is being reported. For loans that are not in bankruptcy and delinquent, only the delinquent principal payment amount is being reported. The result is that the entire amount of delinquent debt is not being represented accurately in this aging schedule. For all loans that are delinquent, the amount of delinquent debt reported on the SF 220-9 should be the entire outstanding principal balance. This is consistent with Treasury guidance which states “the entire

amount of debt is recorded as delinquent if any part of it has been delinquent more than 180 days.”

PART 2, SECTION A: DELINQUENT DEBT 180 DAYS OR LESS

This section of the SF 220-9 captures delinquent debt information on the collection tools and techniques outlined in the DCIA. This section is designed to provide specific information on the actions an agency is taking to collect on its debts between 1 and 180 days delinquent.

FCC Report on Receivables Due From the Public; March 31, 1999 (Unaudited)

Part 2 – Debt Management Tool and Technique Performance Data		
	Number	Dollars
Section A		
Delinquent Debt 180 Days or Less		
1 Total Delinquencies 1 – 180 Days (+)		\$18,861,372
(A) In Bankruptcy (+)	0	0
(B) In Forbearance or In Formal Appeals Process (+)	0	0
(C) In Foreclosure (+)	0	0
(D) At Private Collection Agencies (+)	0	0
(E) In Litigation (+)	0	0
(F) Eligible for Internal Offset (+)	0	0
(G) In Wage Garnishment (+)	0	0
(H) At Treasury for Cross Servicing (+)	0	0
(I) At Treasury for Offset (+)	0	0
(J) At Agency (+)	0	0
(K) Other – must footnote (+)	0	0

Recommendations

As discussed above, the FCC should not report any loan amounts as being between 1 and 180 days delinquent. Installment payment rules provide for two automatic 90-day grace periods; the combined sum of these grace periods may exceed 180 days due to the FCC’s rules for calculating time periods that end on a weekend or holiday. Treasury does not consider a loan delinquent until the end of any contractually provided grace period. This section should report all zero’s unless current installment payment rules change.

PART 2, SECTION B: DELINQUENT DEBT 181 DAYS AND OVER

This section of the SF 220-9 captures delinquent debt information according to eligibility for referral to Treasury for offset and cross-servicing. This section is designed to assist in identifying what actions agencies are taking to collect seriously delinquent debt, relative to compliance with the DCIA.

FCC Report on Receivables Due From the Public; March 31, 1999 (Unaudited)

Part 2 – Debt Management Tool and Technique Performance Data		
	Number	Dollars
Section B		
Debt Eligible for Referral to Treasury for Offset and Cross-Servicing		
1 Debt Eligible for Referral to Treasury for Offset		
(A) Delinquent Debt Over 180 Days		\$7,117,674,767
(B) In Bankruptcy (-)	154	-7,095,543,360
(C) Foreign/Sovereign Debt (-)	0	0
(D) In Forbearance or Formal Appeals Process (-)	0	0
(E) In Foreclosure (-)	0	0
(F) Other – must footnote (+ or -)	0	0
(G) Debt Eligible for Referral to Treasury for Offset (+)	0	22,131,397
2 Debt Eligible for Referral to Treasury or a Designated Debt Collection Center for Cross Servicing		
(A) Debt Eligible for Referral to Treasury for Offset (+)	0	22,131,397
(B) At PCA's (-)	0	0
(C) In Litigation (-)	0	0
(D) Eligible for Internal Offset (-)	0	0
(E) Other – must footnote (+ or -)	0	0
(F) Debt Eligible for Referral to Treasury/Designated Debt Collection Center for Cross Servicing (+)	0	\$22,131,397

Recommendations

As of the date of the SF 220-9 reviewed for this report, the FCC should not be reporting that any of its debt is eligible for referral to Treasury because it does not appear to fit the criteria for referral under the DCIA. The delinquent debt is either tied up in bankruptcy or the Commission expects to apply proceeds against the outstanding debt from the amounts garnered at a

subsequent auction. Accordingly, the \$22,131,397 reported as eligible for referral to Treasury on the March 31, 1999 SF 220-9 should have been classified as in foreclosure. However, if the FCC conducts a subsequent auction of a canceled license, satisfying only part of the outstanding debt, the difference between the outstanding principal and the amount recovered may be a receivable eligible for referral to Treasury and should be classified as such at that time.

PART 2, SECTION C: COLLECTIONS

This section of the SF 220-9 captures information on all collections of delinquent accounts by management tool and technique. This section is designed to assist agencies in assessing the effectiveness of their current debt collection strategies.

FCC Report on Receivables Due From the Public; March 31, 1999 (Unaudited)

Part 2 – Debt Management Tool and Technique Performance Data		
	Number	Dollars
Section C Collections		
1 Collections on Delinquent Debt		\$0
(A) By Private Collection Agencies (+)	0	0
(B) By Litigation (+)	0	0
(C) By Internal Offset (+)	0	0
(D) By Third Party (+)	0	0
(E) By Asset Sales (+)	0	0
(F) By Wage Garnishment (+)	0	0
(G) By Treasury/Designated Debt Collection Center Cross Servicing (+)	0	0
(H) By Treasury Offset (+)	0	0
(I) By Agency (+)	0	0
(J) Other – must footnote (+)	0	0

Recommendations

Because this section has not been filled out by the FCC, it gives the impression that the Commission is taking no debt collection actions against its delinquent debt. This is not the case. As discussed above, the delinquent debt is either in bankruptcy or the Commission expects to apply proceeds against the outstanding debt from the amounts garnered at a subsequent auction. Accordingly, this section should be completed to reflect that the amount in bankruptcy is in

litigation, and should show the outstanding amount awaiting application of proceeds from a subsequent auction listed as "other". The FCC should footnote the specific collection actions being taken at the agency (i.e. borrower notification of default, auction of a new license).

PART 2, SECTION D: DEBT DISPOSITION

This section of the SF 220-9 captures information on the number and dollar amount of selected categories of written-off delinquent debt. This section is designed to identify the amount of debt which has been written off, but on which the agency is still pursuing collection action (not closed out), and the amount that has been both written off and closed out and reported to the IRS as cancellation of indebtedness for tax collection purposes.

FCC Report on Receivables Due From the Public; March 31, 1999 (Unaudited)

Part 2 – Debt Management Tool and Technique Performance Data		
	Number	Dollars
Section D Debt Disposition		
1 Written Off and Not Closed Out (+)	0	\$0
(A) At Private Collection Agencies (+)	0	0
(B) At Treasury/Designated Debt Collection Center for Cross (+)	0	0
(C) At Treasury for Offset (+)	0	0
(D) Other – must footnote	0	0
2 Reported to IRS on Form 1099-C (+)	0	0

Recommendations

The FCC has not written off any debt determined to be uncollectible, thus this section is currently not used by the FCC. Should the Commission decide to write-off any delinquent debt, the number and dollar amount of receivables written-off should be reported in this section as either not closed-out (if FCC is still pursuing collection) or reported to the IRS on Form 1099-C.

PART 3: FOOTNOTES

Footnotes are required whenever an agency's criterion is inconsistent with Treasury's definition of data requirements. The FCC currently gives only the breakout of loans in bankruptcy in the footnotes to its SF 220-9. We suggest the FCC also consider including the following information in its footnotes:

- brief summary of installment payment rules which cause no loans to be classified as delinquent between 1 and 180 days;
- brief summary of debt collection actions being performed by the FCC under Part 2, Section C.



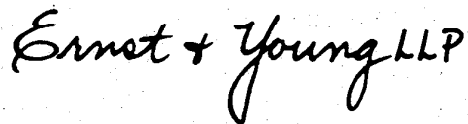
OFFICE OF INSPECTOR GENERAL
FEDERAL COMMUNICATIONS COMMISSION

DEBT MANAGEMENT OBSERVATIONS AND
RECOMMENDATIONS

JUNE 18, 1999

Office of Inspector General
Federal Communications Commission
445 12th St., S.W.
Washington, D.C. 20554

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June 18, 1999

DEBT MANAGEMENT OBSERVATIONS AND RECOMMENDATIONS

TABLE OF CONTENTS

Overview	1
Portfolio Performance Reporting.....	1
Demand Letters.....	1
Front End Controls.....	2
Private Sector Financing	2
Asset Sales.....	2
Gather Borrower Credit Information.....	3
Procedures for Transfer of Installment Debt to Treasury.....	3
Procedures for Accounting for Return of Defaulted Licenses.....	3
Loan Files.....	4
Loan Servicing Responsibilities.....	4
Inter-Bureau Communication	4

DEBT MANAGEMENT OBSERVATIONS AND RECOMMENDATIONS

OVERVIEW

The following document is provided as part of our consulting services conducted for the Federal Communications Commission ("FCC" or "Commission") Office of the Inspector General ("OIG") under Purchase Order P995402039. The recommendations provided herein are meant to respond to specific findings associated with the completion of the relevant portions of the Performance Review Guide, published by the Department of Treasury Office of the Inspector General, related to the Federal government-wide President's Council on Integrity and Efficiency ("PCIE") Review of Non-Tax Delinquent Debt.

Our consulting services were performed to assist the FCC OIG in its assessment of the FCC's Spectrum Auction installment debt management practices. Our work was conducted in accordance with consulting standards of the American Institute of Certified Public Accountants and did not constitute an audit, internal control evaluation or any other form of assurance on any financial information or debt management practices of the FCC.

This document assumes the FCC has a secured interest in the license associated with an installment loan and that upon default, a new license related to the same service and market of the canceled license can be subsequently auctioned with the proceeds raised applied to the outstanding loan amount of the defaulted debtor.

PORTFOLIO PERFORMANCE REPORTING

Observation: There has been insufficient monitoring and reporting of the performance of the installment loan portfolio.

Recommendation: An important aspect of the loan servicing function is monitoring the portfolio and related transactions. This is often accomplished through reviewing portfolio reports on a regular basis, such as monthly. Currently, there are no monthly portfolio performance or tracking reports being reviewed by the loan servicing personnel of the FCC for debt collection purposes. These reports, many of which can be generated from the Nortridge system, should be prepared and reviewed on a regularly scheduled basis. Officials from the Wireless Telecommunications Bureau and the Financial Operations Division (the two chief parties responsible for loan servicing and debt collection) should conduct a status meeting, at a minimum of once a month, to discuss the reports, performance issues, and collection strategies.

DEMAND LETTERS

Observation: Demand letters are not issued regularly to delinquent debtors of the FCC.

Recommendation: With increased reporting and monitoring of the performance of the installment loan portfolio, demand letters should be issued with the same regularity as billing statements. Demand letters should notify the borrower that they are past due, that applicable late

fees will be charged, and that payment must be received by a certain date or additional penalties will be applied. At major milestones in the "non-delinquency" periods (such as 90-days past due, 120-days past due, and just before 180-days past due) efforts should be made, such as a telephone call, to inform the borrower of the seriousness of their delinquency, and the pending cancellation of their licenses if payment is not received by the 180th day.

FRONT END CONTROLS

Observation: The FCC has used insufficient front-end controls when granting installment loans to licensees.

Recommendation: Consistent with guidance from OMB regarding credit applicant screening, the FCC should consider independently verifying the information provided by loan applicants. The FCC should also consider making an independent determination of the applicant's ability to repay the loan, as well as a satisfactory history of repaying debt. Credit reports and supplementary data sources, such as financial statements and tax returns, could be used to verify or determine revenues, held assets, credit history, and financial viability. To the extent the Commission determines that creditworthiness criteria causes tension with the program's goal of increasing the participation of start-up companies with few assets and limited revenues, in the spectrum auction program, the Commission should consider other means for controlling credit risks.

PRIVATE SECTOR FINANCING

Observation: Lack of private sector financing has contributed to the current level of delinquent debt.

Recommendation: If the FCC decides to continue the installment loan program, it should consider implementing some mechanism, in addition to the existing down payment requirement, to ensure that businesses granted spectrum licenses are able to fulfill their financial commitment to the FCC. From the limited history of the installment loan program to date, it appears that one of the leading causes of default by licensees is the inability to raise sufficient capital to cover their obligation to the FCC and build-out their systems. There is a built in lag time in the regulatory process between the end of an auction and the grant of licenses to the winners. During this period, participants in the marketplace have the opportunity to petition the FCC to deny the granting of the license to the winning licensee. The Commission, for example, might consider using this time to allow licensees in the installment loan program to secure private financing as a prerequisite for the license being granted.

ASSET SALES

Observation: The Commission has not used sales of delinquent debt as a means of debt collection.

Recommendation: The FCC should study the possibility of asset sales of delinquent debt. A less costly alternative to servicing and collecting on delinquent debt may be to focus efforts on clearing the legal and regulatory obstacles to selling delinquent installment loans instead of contending with expensive bankruptcy cases and servicing other delinquent loans.

GATHER BORROWER CREDIT INFORMATION

Observation: The FCC has not gathered financial or credit information on borrowers with delinquent debt.

Recommendation: Collecting debtor financial and credit information is critical in order to consider repayment and compromise offers. It is difficult to adequately consider restructure/collection strategies if the FCC does not have a complete understanding of the financial condition of its borrower(s). The Commission should gather financial information on its borrowers, such as financial statements, credit reports, tax returns, etc. to understand and verify the financial condition of its borrowers and as a step in monitoring the performance of its portfolio.

PROCEDURES FOR TRANSFER OF INSTALLMENT DEBT TO TREASURY

Observation: The FCC does not have any formal written procedures to document, certify, and transfer delinquent installment debt that is eligible to be transferred to the Department of Treasury ("Treasury").

Recommendation: Treasury officials have stated that the FCC is not required to transfer its debt to Treasury. This is a result of 1) the Commission expects to apply proceeds against the outstanding debt from the amounts garnered at a subsequent auction, and 2) a large portion of the portfolio is in bankruptcy. However, the FCC should have procedures in place that illustrate how to document, certify, and transfer its loans to Treasury, so that when the current obstacles to referral have been cleared the Commission will know exactly what needs to be performed. The FCC should also define procedures for writing-off loans returned by Treasury as uncollectible. Given the unique nature of the Spectrum Auction installment loan portfolio, the FCC should get a memorandum of understanding from Treasury regarding the applicability of transfer requirements and formalize specific criteria for referral of delinquent FCC installment debt to Treasury.

PROCEDURES FOR ACCOUNTING FOR RETURN OF DEFAULTED LICENSES

Observation: The FCC has no formal accounting procedures to value spectrum licenses returned to the FCC through foreclosure or other means.

Recommendation: FASAB 2 requires when property is transferred from borrowers to a Federal credit program, through foreclosure or other means, in partial or full settlement of post-1991 direct loans, the property is recognized as an asset at the present value of its estimated future net cash inflows discounted at the original discount rate. When the FCC cancels a defaulted license,

it will need to value that asset for accounting purposes. Accordingly, the FCC should establish accounting policy to handle the cancellation of licenses from borrowers in default.

LOAN FILES

Observation: Some loan files are lacking key loan information as well as other relevant documentation related to the loan.

Recommendation: The FCC will need to ensure that all pertinent loan documents are located. If the FCC is unable to locate such information, the FCC may want to consider recreating the information. The FCC should adopt a formal policy and written procedures based on the current loan file checklist for the creation and maintenance of its loan files.

LOAN SERVICING RESPONSIBILITIES

Observation: Loan servicing and debt collection responsibilities have not been clearly defined and have not been consistently performed within the FCC.

Recommendation: Loan servicing responsibilities for the Spectrum Auction installment loan portfolio have recently been transferred from the Financial Management Services in Birmingham to the Credit and Debt Management Center at the FCC. However, the FCC has stated previously in Commission documents that it does not have the resources or the expertise to function effectively as a creditor. If this is the case, the FCC should contract loan servicing responsibilities to a **private** contractor who has the financial resources and financial incentive to maximize collections to the Commission. The FCC is currently interviewing third party loan servicing contractors. The Commission should take action to move loan servicing responsibilities to one of these contractors as quickly as possible.

INTER-BUREAU COMMUNICATION

Observation: Several Financial Operations Division officials have communicated in interviews conducted in the preparation of the Review Guide that they are sometimes excluded from meetings and discussions regarding servicing and collection strategies related to the installment loan program.

Recommendation: The Chief Financial Officer ("CFO") of the FCC or a member of the CFO staff should always be given the opportunity to participate in any meetings or discussions related to the spectrum auction program. This would include the consideration of any repayment or compromise offer. It is important to include personnel of the Commission who are responsible for servicing, accounting, and reporting on spectrum licenses and loan receivables.



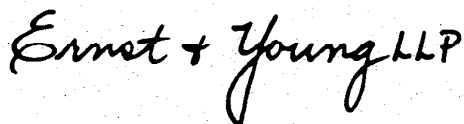
OFFICE OF INSPECTOR GENERAL
FEDERAL COMMUNICATIONS COMMISSION

OVERVIEW OF DELINQUENT DEBT AND DEBT
MANAGEMENT ACTIVITIES

JUNE 18, 1999

Office of Inspector General
Federal Communications Commission
445 12th St., S.W.
Washington, D.C. 20554

This document is provided as part of our consulting services conducted for the Federal Communications Commission ("FCC" or "Commission") Office of Inspector General ("OIG") under purchase order P995402039. Pursuant to our statement of work, this document provides an overview of the FCC's Spectrum Auction installment loan program, summarizes the criteria for classifying the FCC's Spectrum Auction installment loan activity as non-tax delinquent debt, as defined by the Debt Collection Improvement Act of 1996 ("DCIA"), identifies an estimate of the amount of the FCC's non-tax delinquent debt, discusses the FCC's front-end controls related to the Spectrum Auction installment program, and describes FCC's current debt collection procedures and efforts to reduce potential losses. We accept no responsibility to update or revise this document for events that occur or new information that becomes available subsequent to the date of this document.



June 18, 1999

TABLE OF CONTENTS

Executive Summary	1
General Background.....	4
DCIA Definition of Non-Tax Delinquent Debt.....	7
Amount of Delinquent Debt	10
FCC Front-End Controls	12
Installment Debt Collection Procedures and Efforts to Minimize Potential Losses	14
• C block Restructuring	17
• Bankruptcy Efforts	20
• Transfer of Delinquent Debt to Treasury	20
• FCC Collectibility Assessments	21
Appendices:	
1. Summary of DCIA Requirements	24
2. Notes Regarding Estimation of Delinquent Debt.....	26

EXECUTIVE SUMMARY

This document is provided as part of our consulting services conducted for the Federal Communications Commission ("FCC" or "Commission") Office of Inspector General ("OIG") under purchase order P995402039. Pursuant to our statement of work, this document provides an overview of the FCC's Spectrum Auction installment loan program, summarizes the criteria for classifying the FCC's Spectrum Auction installment loan activity as non-tax delinquent debt, as defined by the Debt Collection Improvement Act of 1996 ("DCIA"), identifies an estimate of the amount of the FCC's non-tax delinquent debt, discusses the FCC's front-end controls related to the Spectrum Auction installment program, and describes FCC's current debt collection procedures and efforts to reduce potential losses.

Our consulting services were performed to assist the FCC OIG in its assessment of the FCC's debt management practices. Our work was conducted in accordance with consulting standards of the American Institute of Certified Public Accountants and did not constitute an audit or any other form of assurance on any financial information or debt management practices of the FCC. In performing this task, interviews were conducted and documentation researched to obtain a general understanding of the FCC's debt collection procedures. Various relevant regulatory guidance was also reviewed. This project is one of several consulting projects we are performing for the FCC on a variety of debt portfolio related matters.

As requested by the FCC OIG, this document focuses only on the FCC's Spectrum Auction installment loan program. When a reference is made to FCC "debt" and/or "loans", it is meant to refer to the receivables resulting from the auction installment loan program. This document assumes the FCC has a secured interest in the license associated with an installment loan and that upon default, a new license related to the same service and market of the canceled license can be subsequently auctioned with the proceeds raised applied to the outstanding loan amount of the defaulted debtor.

The type of financing offered under the FCC Spectrum Auction installment loan program appears consistent with the definition of "debt" in the DCIA and the definition of a "direct loan" in OMB guidance. The DCIA defines a loan as "delinquent" if it has not been paid by the

payment date or by the end of any grace period contractually provided. Because FCC auction installment payment rules allow two automatic 90-day grace periods, an FCC auction installment loan would generally be considered delinquent on the 181st day after payment is due provided that no waiver has been timely requested by the borrower or granted by the FCC.

The FCC is currently experiencing significant collection issues with its installment loan portfolio. Based on the unaudited March 31, 1999 Trial Balance from the Nortridge Loan Tracking System, the FCC had 1,774 loans outstanding to approximately 400 borrowers. Of these 400 borrowers, approximately 180 borrowers were delinquent on at least one installment loan. Of the approximately \$8.8 billion in outstanding principal as of March 31, 1999, approximately \$7.0 billion (80%) is delinquent. The amount of delinquent debt reflects the entire outstanding principal balance for those loans with a delinquent installment payment, not just the past due portion of the debt (See Note on Page 10 for additional information). Of this amount, almost \$6.8 billion is tied up in various licensee bankruptcy proceedings. Approximately \$6.6 billion of this amount is attributable to three C block borrowers. (These amounts were derived from unaudited sources including the Nortridge Loan Tracking System and spreadsheets obtained from Wireless Telecommunications Bureau and Financial Operations Division officials). FCC management has stated that the Office of the General Counsel of the FCC together with the Department of Justice are vigorously litigating bankruptcy cases to recover FCC licenses. For OMB credit subsidy estimate and re-estimate purposes, the Commission has obligated budget authority equal to approximately \$5.4 billion, or approximately 60% of the face amount of its C and F block installment loans to cover potential losses on these portfolios.

Based on discussions with FCC management and other information obtained, the high level of FCC's delinquent debt is due to a number of contributing factors including, but not limited to, balancing program social goals with the need for front-end loan underwriting, changes in market conditions, and inability of licensees to raise additional capital. The FCC's collection efforts have also been hampered by various internal and external accounting and organizational problems, such as:

- unclear and undefined internal FCC debt collection policies, procedures and responsibilities;
- non-performance of certain debt collection activities;
- insufficient reporting and monitoring of installment loan portfolio performance; and
- difficulties and problems with the outsourced Nortridge Loan Tracking System.

To address the current situation, the FCC is taking steps to improve debt management practices, including defining the bureaus and offices responsible for collection actions as well as formalizing and documenting debt management policies and procedures. It is also transferring loan servicing and collection responsibilities from FMS to the FCC's Credit and Debt Management Center ("CDMC") in Washington, D.C. The FCC is also adding additional finance and accounting staff to increase its internal loan servicing and debt management capabilities and resources. These steps are being taken to ensure better internal controls, consistency in processing standards, compliance with Federal laws and regulations, and better protection of the financial assets of the Federal government.

GENERAL BACKGROUND

According to FCC management, the FCC has awarded over 7,500 licenses to auction winners who are either offering or preparing to offer services to the public in nine different wireless and satellite categories. Many of these auction winners have participated in the installment loan program. Winning net bids in FCC spectrum auctions totaled over \$23 billion, with over \$13 billion of this amount collected for the U.S. Treasury to date.

The installment payment program of the FCC was established to enable businesses to pay for spectrum licenses who might otherwise not be able to acquire licenses through the FCC's auction process. The Communications Act of 1934 ("the Act"), as amended, mandates the FCC to promote "economic opportunity and competition and ensure that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women."

To accomplish the objectives of the Act, the FCC was granted authority to "consider alternative payment schedules and methods of calculation, including lump sums or guaranteed installment payments." The FCC decided to provide installment financing in seven of its spectrum auctions, including the broadband Personal Communications Services ("PCS") C and F blocks, the regional narrowband PCS, Interactive Video and Data Service ("IVDS"), Multipoint Distribution Service ("MDS"), and 900MHz Specialized Mobile Radio ("SMR"). Installment payments were first offered in 1994 in the IVDS auction.

Under the installment financing program, winning bidders were generally given five to ten years to repay their bid amount (net of a 10% to 20% required down payment) in quarterly installment payments with up to six-year interest-only payment periods at the beginning of the loan term. Interest rates generally varied between 6% and 9.5%, well below market rates, depending on the type of borrower.

Over 95% of the Spectrum Auction winners who were eligible for the installment payment program participated in it. The FCC believes that the installment payment program furthered the

Congressional mandate to provide opportunities for designated entities. The Commission also believes these payments placed it in the role of being both a regulator and a lender to the wireless industry it licenses.

As requested by the Inspector General of the Federal Communications Commission, this document focuses only on the FCC's installment loan program. When a reference is made to FCC "debt" and/or "loans", it is meant to refer to the receivables resulting from the auction installment loan program. This document assumes the FCC has a secured interest in the license associated with an installment loan and that upon default, a new license related to the same service and market of the canceled license can be subsequently auctioned with the proceeds raised applied to the outstanding loan amount of the defaulted debtor.

In performing our procedures, key FCC staff and contractors involved in FCC's spectrum auction installment loan program were interviewed based on the list of questions contained in the President's Council on Integrity and Efficiency's ("PCIE") *"Review of Non-Tax Delinquent Debt"* guide published by the Department of Treasury Office of Inspector General. Within the FCC, officials in the Auctions Division of the Wireless Telecommunications Bureau ("WTB"), the Financial Operations Division of the Office of the Managing Director ("OMD"), and the Office of the General Counsel ("OGC") were interviewed. Also, various FCC contractors and contractors at Financial Management Services ("FMS") of the Department of Treasury ("Treasury") were interviewed.

In addition, Treasury and other non-FCC staff with knowledge of and responsibility for overseeing and implementing the FCC's debt collection activities, or collecting FCC's delinquent debt were interviewed. Various accounting and finance data and background material were gathered from the FCC regarding its installment loans and debt management practices and considered in performing our work.

The FCC is currently experiencing significant collection issues with its installment loan portfolio. Based on the unaudited March 31, 1999 Trial Balance from the Nortridge Loan Tracking System, the FCC had 1,774 loans outstanding to approximately 400 borrowers. Of these 400 borrowers, approximately 180 borrowers were delinquent on at least one installment loan. Of the approximately \$8.8 billion in outstanding principal as of March 31, 1999,

approximately \$7.0 billion (80%) is delinquent. The amount of delinquent debt reflects the entire outstanding principal balance for those loans with a delinquent installment payment, not just the past due portion of the debt (See Note on Page 10 for additional information). Of this amount, almost \$6.8 billion is tied up in various licensee bankruptcy proceedings. Approximately \$6.6 billion of this amount is attributable to three C block borrowers. (These amounts were derived from unaudited sources including the Nortridge Loan Tracking System and spreadsheets obtained from Wireless Telecommunications Bureau and Financial Operations Division officials.) FCC management has stated that the Office of the General Counsel of the FCC together with the Department of Justice are vigorously litigating bankruptcy cases to recover FCC licenses. For OMB credit subsidy estimate and re-estimate purposes, the Commission has obligated budget authority equal to approximately \$5.4 billion, or approximately 60% of the face amount of its C and F block installment loans to cover potential losses on these portfolios.

The C block auction closed about six months before the drop (during winter of 1996) in telecommunications company stock prices. This decline in the telecommunications market made it difficult for some borrowers to raise equity capital for their businesses. According to FCC management, these borrowers paid on average three times more for their licensees than licensees in auctions where installment payment programs were not offered. According to published articles, many of these borrowers believed the premiums were justified when the generous financing terms of the government were considered.

Based on discussions with FCC management, other contributing factors to the level of delinquent installment debt include, but are not limited to:

- lack of borrower credit quality requirements and limited front-end controls employed by the FCC in making installment loans;
- generous financing terms which may have increased the price of spectrum licenses;
- Wall Street investors who did not follow through on plans to provide credit to small licensees;

- Global changes in capital market affecting everyone, especially small businesses.

Based on discussions with FCC management, the FCC's collection efforts have also been hampered by various internal and external accounting and organizational problems, such as:

- unclear and undefined internal FCC debt collection policies, procedures and responsibilities;
- non-performance of certain debt collection activities;
- insufficient reporting and monitoring of installment loan portfolio performance; and
- difficulties and problems with the outsourced Nortridge Loan Tracking System.

To address the current situation, the FCC is taking steps to improve debt management practices, including defining the bureaus and offices responsible for collection actions as well as formalizing and documenting debt management policies and procedures. It is also transferring loan servicing and collection responsibilities from FMS to the FCC's CDMC in Washington, D.C. The FCC is also adding additional finance and accounting staff to increase its internal loan servicing and debt management capabilities and resources. These steps are being taken to ensure better internal controls, consistency in processing standards, compliance with Federal laws and regulations, and better protection of the financial assets of the Federal government.

DCIA DEFINITION OF NON-TAX DELINQUENT DEBT

The main objective of the Debt Collection Improvement Act of 1996 ("DCIA") is to maximize the collection of delinquent debts owed to the Federal Government by implementing aggressive debt management practices while minimizing debt collection costs. The major mandatory and discretionary requirements to achieve the objectives in the DCIA and related OMB debt collection guidance are summarized in Appendix 1. The DCIA defines a *debt* as any amount of money, funds, or property that has been determined by an appropriate official of the Federal Government to be owed to the United States or an agency thereof by a person, including debt administered by a third party as an agent for the Federal Government.

Non-tax debt is defined as any debt other than a debt under the Internal Revenue Code of 1986. There is no requirement that an amount be litigated or adjudicated prior to its consideration as a receivable. However, a debt may not be collectible until the amount is fixed (or is otherwise finally adjudicated).

Public information provided by the Debt Management Services of the Department of Treasury provides the following examples of "debt" under the DCIA:

- loans made, insured, or guaranteed by the government, including deficiency amounts due after foreclosure or sale of collateral (example: student direct and guaranteed loans, Small Business Administration ("SBA") loans, Housing and Urban Development ("HUD") loans);
- expenditures of non-appropriated funds (example: bounced checks to military commissaries);
- overpayments, including payments disallowed by Inspector General audits (example: salary or benefit overpayments, duplicate payments, misused grant funds);
- any amount the U.S. Government is authorized by statute to collect for the benefit of any person (example: Federal Trade Commission ("FTC") consumer redress);
- the unpaid share of any non-Federal partner (i.e., states or local governments) in a program involving a Federal payment and a matching or cost-sharing payment by the non-Federal partner (example: state share of benefit matching program);
- any fines or penalties assessed by an agency (example: civil monetary penalties, Occupational Safety and Health Administration ("OSHA") fines for mine safety violations);
- other amounts of money or property owed to the Government (example: license fees, Freedom of Information Act ("FOIA") fees).

The Office of Management and Budget ("OMB") Circular A-11, *Preparation and Submission of Budget Estimates*, defines a direct loan as a disbursement of funds by the Government to a non-Federal borrower under a contract that requires repayment of such funds with or without interest. This definition includes financing arrangements that defer payment for more than 90 days, including the sale of a government asset on credit terms. Since the terms of the installment loan program allow the licensee to pay for the license over 5 to 10 years, these terms are consistent with the established definition of a direct loan by OMB.

According to FCC management, most of the licenses granted under the installment loan program were generally accompanied by a promissory note and security agreement that established a debt to the Federal government. Certain installment plans that were granted under the installment payment program without written promissory notes still appear to be consistent with the definition of debt in the DCIA as they represent moneys owed to the Federal government from the sale of a license on credit terms.

According to the DCIA, a debt is defined as "delinquent" if it has not been paid by the payment date or by the end of any grace period contractually provided. The current FCC Spectrum Auction installment loan program rules defining installment payments that are past due are as follows:

- Licensees that do not make an installment payment on or before a due date are automatically granted a 90-day grace period ("non-delinquency period") and assessed a late fee equal to 5 percent of the missed installment payment.
- If remittance of the missed installment payment and the 5 percent late fee is not made on or before expiration of the non-delinquency period, a second 90-day period ("grace period") is automatically granted and an additional late fee equal to 10 percent of the missed installment payment is assessed.
- Licensees are not required to make an application to the Commission to receive the non-delinquency period or the grace period.

- Any licensee that becomes more than 180 days past due on an installment payment shall be in default, and the license shall automatically cancel without further action by the Commission.

There are a few exceptions to the above rules that would cause a loan more than 180 days past due not to be in default (examples: pending waiver request, error in recognizing payment). However, based on discussions with FCC management, since FCC Spectrum Auction rules provide for two automatic 90-day grace periods, an installment loan would *generally* be considered “delinquent” subject to the DCIA on the 181st day after the payment due date provided that no waiver has been timely requested by the borrower or granted by the FCC.

AMOUNT OF DELINQUENT DEBT

The amount of delinquent debt shown below reflects the entire outstanding principal balance for those loans which are delinquent, not just the past due portion of the debt. Based on various sources indicated, the amounts of delinquent FCC installment debt are estimated to be as summarized below:

Auction Blocks	Amount of Outstanding Principal Greater Than 180-Days Past Due
#5, #6, #7, #10, #11	\$6,828,000,000
<p>Note: The above figure is from unaudited data derived from the sources indicated below. The above figure may include:</p> <ul style="list-style-type: none"> • licensees over 180-days past due with pending waiver requests that may alter the delinquency status of the loan. • licensees who appear over 180-days past due because a payment was applied incorrectly in the Nortridge Loan Tracking System or was held in suspense. <p>Source: Auction payment schedule provided by Financial Operations Division as of April 27, 1999; Schedule of bankrupt borrowers prepared for SF220-9</p> <p>See Appendix 2 for additional information</p>	

Auction Blocks	Amount of Outstanding Principal Greater Than 180-Days Past Due
#2, #3, #4	\$158,000,000
<p>Note: The above figure is from unaudited data. The above figure may include:</p> <ul style="list-style-type: none"> • licensees over 180-days past due with pending waiver requests that may alter the delinquency status of the loan. • licensees who appear over 180-days past due because a payment was applied incorrectly in the Nortridge Loan Tracking System or held in suspense. <p>Source: Trial Balance from Nortridge Loan Tracking System as of 3/31/1999.</p> <p>See Appendix 2 for additional information</p>	

Since the FCC's installment payment rules provide for two automatic grace periods totaling 180 days, the FCC installment debt is generally considered "delinquent" per DCIA guidance on the 181st day after payment is due. The Nortridge Loan Tracking System is used by the FCC and Treasury FMS in Birmingham, Alabama (FCC's contracted loan servicer) to maintain its installment loan portfolio. The FCC prepares past due reports for its auction blocks #5 ("C block" – Broadband PCS Auction), #6 ("MDS" – Multipoint/Multichannel Distribution Services Auction), #7 ("SMR" – Specialized Mobile Radio Service Auction), #10 ("C block" – Broadband PCS Auction), and #11 ("F block" – Broadband PCS Auction). (The other auction blocks, #2 ("IVDS" – Interactive Video and Data Services), #3 (Narrowband PCS), and #4 (Broadband PCS)¹ had no written loan agreements and are not considered by the FCC to be covered under the Credit Reform Act of 1990 ("Credit Reform Act") according to FCC management. We understand that based on an informal agreement between OMB and the FCC, the FCC did not have to report installment payment plans under auction blocks #2, #3 and #4 as loans under the Credit Reform Act. In auction blocks #1, #8, and #9, the installment payment program was not offered.

¹ The FCC awarded APC, Cox and Omnipoint broadband PCS A/B licenses under the pioneer's preference program. Other licenses in these blocks were sold in Auction 4. These three licenses were not awarded through auction. However, after the licenses were awarded, the Commission required the pioneer preference licensees to pay 85% of the adjusted value of the licenses. The pioneer's preference licensees were permitted to make this payment in installment payments.

FCC FRONT-END CONTROLS

OMB Circular A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*, requires among other things, "Where credit worthiness is a criterion for loan approval, agencies/private lenders shall determine that applicants have the ability to repay the loan, as well as a satisfactory history of repaying debt. Credit reports and supplementary data sources, such as financial statements and tax returns, should be used to verify or determine employment, income, held assets, and credit history."

FCC management has indicated that the *primary* criterion for loan approval was **not the borrower's credit worthiness**. Rather, management stated it had to balance its role as a lender with the objectives in Section 309(j) of the Communications Act that requires it to ensure that small businesses, women, and minorities are given the opportunity to participate in the FCC's auction process. As such, the FCC's criterion for loan approval often required the borrower to fall **below** certain size criteria. For example, C block applicants were required to have gross revenue of *not more than* \$40 million in order to participate in the installment loan program with the most favorable terms. Borrowers with gross revenue between \$40 million and \$125 million could still participate in the installment loan program, but at less favorable loan terms.

FCC management indicated it originally examined additional financial criteria to qualify for the installment loan program. For example, a licensee would need sufficient property, plant, and equipment; cash; and credit to operate for at least one year. However, small borrowers and private investment firms responded to the FCC that this policy was too restrictive and would defeat the purpose of the program since few entities which the installment loan program was designed to assist could meet the one-year financial criteria. The Commission agreed and settled on a 5% down payment when the bidder won at auction, and an additional 5% down payment when the license was granted (some Narrowband, IVDS, MDS, and F block licensees were required to put down 20%).

The Commission performed limited underwriting by requiring applicants to self certify on their auction participation application forms the following:

- that the applicant is legally, technically, financially and otherwise qualified pursuant to 308(b) of the Communications Act and the Commission's Rules and is in compliance with the foreign ownership provisions contained in Section 310 of the Communications Act;
- that the applicant is the real party in interest in the application and that there are no agreements or understanding other than those specified in the application which provide that someone other than the applicant shall have an interest in the license;
- that the applicant is aware that, if upon Commission inspection, this application is shown to be defective, the application may be dismissed without further consideration, and certain fees forfeited. Other penalties may apply;
- that the applicant has not entered into and will not enter into any explicit or implicit agreements or understandings of any kind with parties not identified in this application regarding the amount to be bid, bidding strategies or the particular license on which the applicant or other parties will or will not bid;
- that, if applicant status is claimed, the applicant is eligible for any special provisions set forth in the Commission's Rules applicable to this auction and consents to audits, as set forth in the Commission's Rules, to verify status;
- that the applicant is and will, during the pendency of its application, remain in compliance with any service specific qualifications applicable to the licenses on which the applicant intends to bid including, but not limited to, financial qualifications;
- that the applicant is not in default on any payment for Commission licenses and that it is not delinquent on any non-tax debt owed to any Federal agency.

The Commission also has a "petition to deny" process. Once an entity is declared the winner of a license at auction, other parties have the opportunity to submit to the Commission petitions to deny the grant of the license to the winner. This step in the regulatory process allows the marketplace to respond to a licensee's application and viability as a service provider.

Based on discussions with FCC management, the FCC did not perform additional underwriting analysis on its applicants or verify the self-certifications made by applicants. The FCC required applicants to submit gross revenues for the preceding three years and aggregate gross revenue for the past three years, but did not require the applicants to submit financial statements. Revenue figures were not used as an indicator of credit worthiness, but to support that the borrower qualified as a "designated entity." The FCC did not use credit reports to evaluate credit worthiness.

According to FCC public documents, the Commission stated it did not have either the resources or the expertise to independently determine a borrower's credit worthiness, evaluate operating performance, or develop financial covenants to ensure compliance with loan agreements. It therefore assumed that if a bidder could raise the upfront payment in the financial markets, that the market recognized the bidder as sufficiently financially sound and able to provide services as an auction winner.

Almost 80% of the \$8.8 billion in outstanding auction loan principal balance as of March 31, 1999 has become delinquent based on the guidance outlined in the DCIA. The minimal level of front-end underwriting controls used by the FCC appears to have been a contributing factor to the amount of delinquent debt.

INSTALLMENT DEBT COLLECTION PROCEDURES AND EFFORTS TO MINIMIZE POTENTIAL LOSSES

According to FCC management, no formal, consolidated written procedures currently exist regarding installment debt collection at the FCC, nor have the debt collection responsibilities of the FCC's bureaus and offices been clearly defined. The FCC bureaus have a myriad of small procedure manuals, memos, and other documents that are used for guidance by FCC personnel when making debt management decisions. However, these documents have not been consolidated into a single, consistent, approved agency-wide manual. Most of the existing limited procedure manuals and memos used for debt management serve as precedent only; they do not represent Commission management approved policy and procedures.

The FCC's Office of the Managing Director is currently involved in developing formal debt management guidelines. The FCC has announced plans for the drafting of a loan processing and procedures manual and a standard debt collection operating procedures manual. The Wireless Telecommunications Bureau is also in the process of drafting their debt management procedures.

Based on a Memorandum of Understanding ("MOU") signed June 28, 1996 between FMS and the FCC, the responsibility for most debt collection actions transferred in 1996 to FMS. The FCC authorized FMS to take the following steps on the FCC's behalf:

- send a demand letter for the amount of the total obligation including principal, interest, and any collection or administrative fees and expenses on the 10th calendar day after notifying the FCC of the delinquency;
- contact the debtor by telephone if no payment is received by the 20th calendar day after notifying the FCC of the delinquency;
- handle repayment or compromise offers and agreements, subject to FCC approval;
- report accounts to credit bureaus as past due, after the 100th day overdue;
- purchase and evaluate credit reports to identify the best future collection action;
- conduct asset searches and skiptracing;
- refer delinquent accounts for offset, and to private collection agencies;
- upon approval, refer accounts to Department of Justice ("DOJ") for litigation;
- track and monitor collection actions taken by agencies to which FMS has referred accounts, such as private collection agencies and DOJ;
- accrue interest and late charges on outstanding amounts in accordance with current statutory and regulatory authorities, and as agreed with FCC;
- notify FCC in the event that FMS receives information that the debtor is filing for bankruptcy;

- recommend license revocation to FCC;
- recommend write-off to FCC Debt Collection Officer;
- file Form 1099-C with the Internal Revenue Service ("IRS") on accounts on which FCC decides not to pursue collection;

According to FCC management, FMS has not performed its debt collection responsibilities under the MOU with the FCC. According to FMS officials, FMS needed authorization from the FCC before they could take any debt collection action against a licensee. Also, according to FMS officials, the FCC did not request or authorize FMS to take any debt collection actions on FCC's behalf. As a result, both the FCC Wireless Telecommunications Bureau and the Office of the Managing Director have informally assumed many of these responsibilities on an ad hoc basis. However, not officially reassigning these debt collection actions to FCC personnel appears to have been a contributing factor to inconsistencies and delays in taking debt collection actions. These debt collection activities are to be formally transferred back to the FCC effective June 1, 1999.

FMS was also responsible under the MOU for providing several reports on a monthly basis regarding the installment loan portfolio. However, according to FCC management, these reports have not been provided on a regular basis. FMS provides the FCC with a weekly status report detailing tasks accomplished and open issues. FMS does not, however, monitor the delinquency and collection performance of the installment loan portfolio. The Commission plans to improve the monitoring and reporting of its installment loan portfolio as it moves the servicing function back from FMS's offices in Birmingham, Alabama to the FCC's Financial Operations Division in Washington, DC.

The Wireless Telecommunications Bureau and Financial Operations Division are working with contractor assistance to improve debt management procedures at the FCC. They have prepared consolidated loan files and are checking that loan source documents are available to support loan balances. They have created financial models to re-calculate loan balances from source documents. Such re-calculated loan balances will be used to send confirmation letters to

borrowers. Approximately 235 licensees (181 MDS and 54 SMR) have been sent confirmation letters as of April 30, 1999. These letters ask licensees to confirm loan balances and terms.

All loan servicing responsibilities are being transferred from the FMS Debt Management Service ("DMS") in Birmingham, Alabama to the Financial Operations Division of the FCC in Washington, D.C. effective June 1, 1999. Third party loan service providers are also being interviewed in an effort to outsource some or all of FCC's loan servicing responsibilities. In addition, the FCC through contractor assistance has reviewed current loan servicing activities in Birmingham to determine where improvements can be made.

As an ongoing process, the FCC's Chief Financial Officer ("CFO") is developing alternative approaches to staffing debt management activities. According to FCC management, seven new in-house "term" employees, paid for with auction proceeds, will be hired to handle loan servicing. In April 1999, a separate Credit and Debt Management Division was created under the CFO.

The Nortridge Loan Tracking System ("NLS"), the FCC's outsourced loan servicing system, is currently being reviewed by the Financial Operations Division to determine its effectiveness as a servicing system. FCC management has stated that problems with NLS are primarily the result of (1) the particular way in which the Nortridge software generates some of its calculations, especially interest, and (2) the unique and constantly changing installment payment program rules that make it difficult for a standard commercial loan servicing software program to manage FCC's installment loans. The FCC is assessing potential deficiencies and considering recommendations to the current loan tracking system of the FCC.

C Block Restructuring

According to public FCC documents, in early 1997, nine broadband PCS C block licensees who participated in the installment payment program indicated they were having difficulty making their scheduled installment payments and requested that the Commission amend the terms of the installment payment program for broadband PCS services. The licensees blamed increased

competition and changing market conditions (i.e. decline in financial markets, lower bid prices in the broadband PCS F block and WCS auctions) for their financial difficulties.

In order to fully consider the licensees' proposals, on March 31, 1997, the Wireless Telecommunications Bureau suspended installment payments for all C block licenses. The Bureau issued a public notice requesting comments on broadband PCS installment payments, and hosted a public forum attended by over 150 licensees and representatives from the wireless industry and financial markets.

In response, the Commission approved an option plan on September 25, 1997 for broadband PCS C block licensees and indicated it would reinstate the installment payment deadline for PCS C and F block licensees as of March 31, 1998. The deadline for submitting elections and the reinstatement of payments was delayed several times due to the large number of petitions for reconsideration and the need to address the issues raised by the petitioners. The deadline for electing an option was moved from January 15, 1998 to June 8, 1998 and the date to resume payments was pushed from March 31, 1998 to July 31, 1998.

C-block licensees not resuming original installment payments could elect one of three options:

1. **Prepayment:** A licensee could purchase any of its licenses at the face value of the outstanding debt on those licenses. A licensee had to purchase all or none of the licenses it owned within any single Metropolitan Trading Area ("MTA"). A licensee could use up to 70% of its down payment on licenses from other MTAs that it did not wish to retain as a credit towards prepaying those licenses that it wished to keep. Licenses automatically canceled in accordance with this option could be replaced with a new license that would be available for subsequent auction. A licensee electing this option (and its affiliates) could not bid at the auction of the new license that replaced the canceled license, and could not otherwise acquire any such license in the secondary market for a period of two years.
2. **Amnesty:** The licensee could return to the Commission any of its licenses so long as all licenses within an MTA were returned. The entire outstanding debt on returned licenses would be forgiven. For licenses that were returned, the licensee had two choices: (a) the

licensee could opt to re-bid on those licenses in the subsequent auction; or (b) the licensee could opt to forgo the opportunity to re-acquire its returned licenses in exchange for a credit of 70% of the down payment already made on the returned licenses. The same choice had to be made for all licenses within an MTA. The 70% credit had to be used to prepay either 30MHz or 15MHz disaggregated licenses retained by the licensee.

3. **Disaggregation:** A licensee could disaggregate all of its 30MHz licenses within an MTA and return 15MHz to the Commission in exchange for forgiveness of 50% of the outstanding debt. For licensees who elected to disaggregate, there were two options, resume payments on the disaggregated license under the terms of the installment payment plan or prepay the outstanding loan balance on the disaggregated license. A licensee who elected to continue installment payments for the disaggregated license would receive a total credit equal to 70% of the original down payment made on the 30MHz disaggregated license. In receiving forgiveness of 50% of the outstanding debt, we understand that the licensee retains the benefit of 50% of the original down payment. In addition, 40% of the down payment associated with the disaggregated spectrum that was returned to the Commission (or 20% of the original down payment) would be used to prepay Suspension Interest (interest on installment payments while payments were deferred) or reduce principal at the licensee's option. For licensees who elected to prepay outstanding debt on the disaggregated license, the licensee would receive a credit equal to 85% of the original down payment made on the 30MHz disaggregated license. This credit represents 70% of the down payment associated with the 15 MHz returned spectrum (or 35% of the original down payment), plus 100% of the down payment associated with the 15 MHz of retained spectrum (or 50% of the original down payment).

In implementing this option plan, the Commission did not review the financial condition of the licensee or make an assessment of the licensee's business plan to restrict licensees to the most appropriate option according to public FCC documents. For example, a delinquent licensee who was having financial difficulty before the option plan could have chosen to resume payments on all licenses, or return half of its licenses in return for forgiveness of half of its debt without having to provide evidence that it could support the debt service. In doing so, the Commission

allowed licensees who had admitted financial difficulty to determine their own financial capability.

Bankruptcy Efforts

Approximately \$6.8 billion of the FCC's delinquent installment debt is currently tied up in bankruptcy. According to FCC management, the Office of the General Counsel of the FCC together with the Department of Justice is vigorously litigating bankruptcy cases to recover FCC licenses. In addition, the FCC is seeking legislation from Congress that would clarify that FCC licensees who default on their installment payments may not use bankruptcy litigation to avoid automatic cancellation of their spectrum licenses.

Transfer of Delinquent Debt to Treasury

The FCC has not transferred any loans more than 180 days past due to Treasury. FCC management, however, indicated the Commission is not required to transfer its installment debt to Treasury in its current status under the requirements of the DCIA.

The FCC rules defining delinquent debt are as follows:

- ⇒ Any licensee that becomes more than 180 days delinquent on an installment payment shall be in default, and the license shall automatically cancel without further action by the Commission (subject to a few exceptions).
- ⇒ In that event the debt shall be transferred to the Department of Treasury for collection subject to the DCIA.

FCC debt that is over 180 days past due generally falls into three categories:

1. defaulted debt in bankruptcy.
2. defaulted debt not in bankruptcy; borrower should be notified of default; and new license for same spectrum auctioned to satisfy debt.

3. debt established from the "Interactive Video and Digital Services" auction is under administrative appeal. (Under DCIA rules, delinquent debts in the administrative appeals process do not have to be transferred to Treasury until after the appeal process is completed and the amount due has been fixed.)

According to the DCIA, a creditor agency is not required to transfer a debt to FMS if the debt is in litigation or foreclosure. Litigation is defined as (1) a debt referred to the Attorney General for litigation by the creditor agency; or (2) a debt that is the subject of proceedings pending in a court of competent jurisdiction, including bankruptcy proceedings, whether initiated by the creditor agency, the debtor, or any other party.

A debt is considered in foreclosure if:

- collateral securing the debt is the subject of judicial foreclosure proceedings in a court of competent jurisdiction; or
- notice has been issued that collateral securing the debt will be foreclosed upon, liquidated, or otherwise transferred pursuant to applicable law in a non-judicial proceeding and the creditor agency anticipates that proceeds will be available from the liquidation of the collateral for application to the debt.

Because the FCC does anticipate that proceeds will be available from the auction of new licenses for application to the installment debt, the FCC does not believe it is required to transfer any loan until it auctions the new license. The receivable transferred to Treasury at such time would then be the equivalent of a deficiency balance (the amount of the installment loan minus the proceeds from the auction of the new license, if greater than \$0.)

FCC Collectibility Assessments

FCC management indicated that the FCC has not made an *overall* financial assessment of the collectibility of its installment loan portfolio. For OMB credit estimate and re-estimate purposes, the Commission obligated budget authority equal to \$5.4 billion, or approximately 60% of the face amount of its C and F block installment loans. This obligation represents the Administration's current estimate of the present value of the future costs (or losses) on these

loans as of the date of origination. The amount includes the net impact of late or missed payments, financing costs, prepayments, defaults, and recoveries according to the *President's Budget for Fiscal Year 2000*.

The FCC is in the process of preparing financial statements for the fiscal year ended September 30, 1999 in connection with an upcoming audit. The FCC has tentatively concluded that it will use the hierarchy of accounting principles and standards for Federal agencies as outlined in OMB Bulletin 97-01, "*Form and Content of Agency Financial Statements*".

The accounting principles and reporting objectives established for the Federal government include the following requirements regarding the assessment of loan receivables:

- Federal Accounting Standards and Advisory Board ("FASAB") Statement of Federal Financial Accounting Standards (SFFAS) No. 2
 - ⇒ Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance.
 - ⇒ A subsidy expense is recognized for loans disbursed during a fiscal year. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows.
 - ⇒ The subsidy cost allowance for direct loans are reestimated each year, taking into account all factors that may have affected the estimated cash flows. Any adjustment resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense.)
 - ⇒ When direct loans are modified, the cost of modification is recognized at an amount equal to the decrease in the present value of the direct loans or the increase in the present value of the loan guarantee liabilities measured at the time of modification.

- ⇒ Upon foreclosure of direct loans, the acquired property is recognized as an asset at the present value of its estimated future net cash inflows.
- ⇒ Direct loans obligated and loan guarantees committed after September 30, 1991, must be accounted for on a present value basis, which is consistent with the intent of the Federal Credit Reform Act of 1990.

Based on SFFAS No. 2 and other standards and guidance established by OMB, the FCC is required to prepare an accounting of its installment loan portfolio based on the present value of the eventual expected cash inflows resulting from the installment loans. This accounting may require the Commission to place a value on its licenses. While the FCC has made a financial assessment of some of its loans for credit subsidy estimate and re-estimate purposes, the FCC maintains it does not value spectrum licenses because (1) this is the job of the marketplace, and (2) it may have a negative impact on pending bankruptcy cases.

APPENDIX 1

Summary of DCIA Requirements

ACTIVITY	AGENCY REQUIREMENT
<i>Offsets Programs (Mandatory)</i>	
<u>Administrative Offset:</u> centralized collection of delinquent debt on behalf of other agencies by withholding or offsetting payments due to the federal government for the debtor.	Agencies are required to refer debts annually to Treasury.
<u>Federal Employee Salary Offset:</u> delinquent accounts are matched against the federal personnel rosters to identify employees delinquent on federal debts. Where there is a match, up to 15% of the employee's disposable income may be offset against delinquent debt owed.	Agencies must match delinquent debtor files against employment files annually.
<u>IRS Tax Refund Offset:</u> delinquent amounts may be offset against a debtor's income tax refund.	Agencies are required to refer debts to Treasury annually.
<i>Prescreening Loan Applicants (OMB A-129 Mandatory)</i>	-Agencies are required to prescreen all loan applicants to determine whether an applicant is credit worthy and has the ability to repay the debt.
<i>Barring Delinquent Federal Debtors From Obtaining Federal Loans or Loan Guarantees (Mandatory)</i>	-Agencies must deny credit to anyone who owes delinquent debt to the Federal Government unless the delinquency has been resolved.
<i>Taxpayer Identification Numbers (Mandatory)</i>	Agencies are required to obtain taxpayer identification numbers for all those doing business with the Federal Government (including lenders, servicers, contractors) and must include this information on all payment vouchers. Agencies must disclose the intended use of this information (to collect and report on delinquent debt).
<i>Referring Debt (Mandatory)</i>	-Agencies must refer debt delinquent over 180 days to Treasury for collection, unless debt has already been referred to "federal debt collection center", a private collection agency, is in litigation, foreclosure, disposed of under an asset sale program,
<i>Referring Debt (Mandatory) cont.</i>	

ACTIVITY	AGENCY REQUIREMENT
	<p>or is exempted by Treasury.</p> <p>-Agencies may refer delinquent debt to a private collection agent, to another federal agency designated to provide servicing for other agencies for a fee, or through an agreement with Treasury to retain servicing.</p>
<i>Reporting Debts (Mandatory)</i>	<p>-Agencies are required to report on an individual's delinquent debts (and may report on non-delinquent debt) to credit reporting bureaus in an effort of improving debtor information to the public and federal agencies.</p> <p>- Lenders are required to report credit extensions to credit bureaus.</p> <p>-Agencies must submit loan write-off information (form 1099-C) to Treasury.</p>
<i>Gainsharing (Discretionary)</i>	<p>Agencies are permitted to share in the financial gains achieved through improved debt collection activities (use of the funds will be subject to appropriation).</p>
<i>Loan Sales (Discretionary)</i>	<p>Agencies are encouraged to sell delinquent debt, particularly debts with underlying collateral.</p>
<i>Sharing Information (Mandatory)</i>	<p>Agencies are required to share delinquent borrower information through submissions to a centralized debt management system within Treasury.</p>
<i>Reporting Requirements (Mandatory)</i>	<p>-Agencies are required to report to Treasury annually on the status of their loans and accounts receivable.</p> <p>-Agencies are required to report to Congress on the value of their portfolios for both current and delinquent debts.</p> <p>-Agencies are required to report to Congress on portfolio performance.</p>

APPENDIX 2

Notes Regarding Estimation of Delinquent Debt

Estimation of Delinquent Debt: Auction Group #'s 5, 6, 7, 10, 11

The estimated amount of delinquent debt was determined from a past due schedule as of April 27, 1999, provided by FCC management for auction group #'s 5, 6, 7, 10, and 11. The schedule did not include four licensees tied up in bankruptcy: NextWave, GWI PCSI, DCR PCS Inc., and American National. The outstanding principal balance for these companies was determined from a separate schedule prepared for these four borrowers. The estimated outstanding principal balance for these four borrowers is as follows:

NextWave:	\$4,368,000.000
GWI PCSI:	\$ 954,000.000
DCR PCS:	\$1,284,000.000
American National:	\$ 3,000.000

Estimation of Delinquent Debt: Auction Group #'s 2, 3, 4

Because a detailed past due schedule was not available for auction blocks #2, #3, and #4, the amount of delinquent debt was determined from the unaudited Trial Balance from the Nortridge Loan Tracking System as of March 31, 1999. The trial balance does not report the number of days past due, but does report the last payment date. From the last payment date, the number of days since the last payment was received can be determined as of March 31, 1999. In these loan groups, most loans are either clearly current (less than 100 days since the last payment was received) or clearly delinquent (more than 365 days since the last payment was received.) A loan is assumed to be delinquent if a payment has not been received in 273 days (scheduled payment date + 92 days until next scheduled payment + 181 days past due = delinquent). This assumes that the last payment was a full payment received on the scheduled payment due date.

Of the 452 licenses with loans outstanding in auction group #'s 2, 3, and 4 as of March 31, 1999:

- 37 licenses (\$428,819,405 outstanding principal balance) had made a payment in the last 91 days – **current**
- 1 license (\$270,687,030 outstanding principal balance) had not made a payment in 149 days – it is assumed that this payment was made on the scheduled payment due date, therefore it is classified as **current**
- 2 licenses (\$101,902 outstanding principal balance) had not made a payment in 161 days – it is assumed that this payment was made on the scheduled payment due date, therefore it is classified as **current**
- 1 license (\$250,848 outstanding principal balance) had not made a payment in 273 days – it is assumed that this payment was made on the scheduled payment due date, therefore it is classified as **delinquent**
- 411 licenses (\$157,779,626 outstanding principal balance) had not made a payment in the last 362 days or more – **delinquent**



OFFICE OF INSPECTOR GENERAL
FEDERAL COMMUNICATIONS COMMISSION

OVERVIEW OF APPROACHES FOR
DETERMINING COLLECTIBILITY OF SPECTRUM
AUCTION LOAN PORTFOLIO

JUNE 18, 1999

Office of Inspector General
Federal Communications Commission
445 12th St., S.W.
Washington, D.C. 20554

This document is provided as part of our consulting services conducted for the Federal Communications Commission ("FCC" or "Commission") Office of Inspector General ("OIG") under Purchase Order P995402039. Pursuant to our statement of work, this document provides recommended approaches for determining the collectibility of the non-tax delinquent debt related to the Spectrum Auction program. We accept no responsibility to update or revise this document for events that occur or new information that becomes available subsequent to the date of this document.

Ernst & Young LLP

June 18, 1999

OVERVIEW OF APPROACHES FOR DETERMINING COLLECTIBILITY OF SPECTRUM AUCTION LOAN PORTFOLIO

TABLE OF CONTENTS

Executive Summary	1
FCC Subsidy Cost Determination Requirements and Guidance	3
Subsidy Cost Estimates	4
FCC Loan Valuation Issues	5
Subsidy Cost Estimation Methodologies.....	6
Bankruptcy	9
Refining Credit Loss Assumptions	11
Next Steps	17
Appendix:	
1. Federal Government Loan Accounting Requirements	18

EXECUTIVE SUMMARY

This document is provided as part of our consulting services conducted for the Federal Communications Commission ("FCC" or "Commission") Office of Inspector General ("OIG") under Purchase Order P995402039. Pursuant to our statement of work, this document provides recommended approaches for determining the collectibility of the non-tax delinquent debt related to the Spectrum Auction program. The recommended approaches assume the FCC has a secured interest in the license associated with an installment loan and that upon default, a new license related to the same service and market of the canceled license can be subsequently auctioned with the proceeds raised applied to the outstanding loan amount of the defaulted debtor.

Our consulting services were performed to assist the FCC OIG in its assessment of the FCC's Spectrum Auction installment loan portfolio. Our work was conducted in accordance with consulting standards of the American Institute of Certified Public Accountants and did not constitute an audit or any other form of assurance on any financial information or debt management practices of the FCC. In performing this task, interviews were conducted and documentation researched to obtain a general understanding of the FCC's installment loan portfolio. Various relevant regulatory guidance was also reviewed. This project is one of several consulting projects we are performing for the FCC on a variety of debt portfolio related matters.

As requested by the FCC OIG, this document focuses only on the FCC's Spectrum Auction installment loan program. When a reference is made to FCC "debt" and/or "loans", it is meant to refer to the receivables resulting from the auction installment loan program.

There are many issues the FCC must consider when determining approaches to estimating the collectibility of its installment loan portfolio including, but not limited to: (1) on-going bankruptcy litigation; (2) Department of Justice ("DOJ") concerns regarding loan valuations; (3) data integrity issues; and (4) difficulties in projecting default and recovery rates. Accordingly, the FCC should consider coordinating with the Office of Management and Budget ("OMB") and

DOJ when determining the most appropriate methodology for assessing the collectibility of the installment loan portfolio, as it applies to the calculation of budget and accounting estimates.

The FCC should consider the relationship between "subsidy estimates" and assessments of the collectibility of outstanding debt. The Federal Credit Reform Act of 1990 ("CRA") requires agencies to calculate annually the estimated long-term cost (subsidy) to the Government of all direct loans, calculated on a net present value basis, excluding administrative costs. The FCC has performed credit subsidy estimates and reestimates for its SMR, MDS, C block and F block installment loans. These credit subsidy estimates are a form of "collectibility assessment" designed to measure the risk of default and recovery potential.

The Federal Accounting Standards Advisory Board ("FASAB") has concluded that since budgetary resources for direct loan and loan guarantee subsidies are required to be reported on a net present value basis, financial reporting of loan activity should be on the same basis as credit subsidy estimates. Accordingly, these subsidy calculations are important not only for budgetary accounting and reporting purposes but also for financial reporting purposes.

The current FCC subsidy cost estimates incorporate contractual loan terms, actual performance of the FCC's loan cohorts up to the most recent reestimate, and credit loss projections for the remaining life of these cohorts based upon the original loss projections. The current subsidy estimates incorporate data from the Nortridge Loan System. The accuracy of the data in this system is currently under review by the FCC. Any adjustments to these data should be reflected in future subsidy reestimates. This report discusses options for improving projections of loan defaults and recoveries in the event of default.

The FCC has limited historical performance data on its loan portfolio. As a result, the FCC should consider a collectibility assessment based on a pro-forma assessment of the credit risk of its licensees. This pro-forma assessment should consider the credit risk factors outlined in the FASAB Statement of Federal Financial Accounting Standards ("SFFAS") No. 2: (1) loan performance experience; (2) current and forecasted international, national, or regional economic conditions; (3) financial and other relevant characteristics of borrowers; (4) the value of collateral to loan balance; (5) changes in recoverable value of the collateral; and (6) newly developed events that would affect the loan's performance. The FCC should also consider how

any changes in its collectibility methodology could be reflected in future subsidy estimates and reestimates.

FCC SUBSIDY COST DETERMINATION REQUIREMENTS AND GUIDANCE

According to the Federal Credit Reform Act of 1990 ("CRA"), the FCC is required to budget for the cost of its installment loan portfolio based on the present value of the expected cash flows resulting from the installment loans. This subsidy cost estimate is defined as the present value of the cash flows to and from the Government resulting from a direct loan or loan guarantee, discounted to the time when the loan is disbursed. The cash flows are the contractual cash flows adjusted for expected deviations from the contract terms (delinquencies, defaults, prepayments, and other factors). The rate used to discount the cash flow should be the interest rate on a Treasury security of similar maturity to the loan.

The CRA also requires the FCC to reestimate the subsidy cost throughout the life of each cohort of direct loans to account for differences between the original assumptions of cash flow and actual cash flow or revised assumptions about future cash flow. There are two types of subsidy reestimate: (1) interest rate reestimate, adjusting for the effect on the subsidy of differences between actual interest rates and the interest rates assumed when funds were obligated for the direct loans or loan guarantees; and (2) technical/default reestimate, adjusting for revised assumptions about loan performance, such as differences between assumed and actual default rates or new projections of prepayments.

The FCC currently estimates a subsidy expense of \$5.5 billion for the \$9.5 billion in installment loans provided as part of the C Block, F Block, SMR, and MDS auction events. This subsidy cost is almost entirely due to the FY 1997 C Block loan cohort, which accounts for \$8.7 billion of the \$9.5 billion original loan volume. The current subsidy rate for the FY 1997 C Block cohort is 61.25 percent. The subsidy rates on the F Block, SMR, and MDS loan cohorts range from 9.58 percent to 24.59 percent. The \$5.5 billion subsidy expense represents the current estimate of the present value of the total costs (or losses), excluding administrative expenses, on these loans as of the date of origination. The amount includes the net impact of estimated late or missed payments, financing costs, prepayments, defaults, and recoveries.

Although the CRA requires the use of present value to measure the subsidy costs of direct loan and loan guarantees for budgetary accounting and reporting, the law does not dictate standards for financial statements and associated reporting. However, the Federal Accounting Standards Advisory Board ("FASAB") concluded that significant benefits would result from integrating budgetary and financial accounting for federal credit programs. FASAB recommended that since budgetary resources for direct loan and loan guarantee subsidies are required to be reported on a net present value basis, financial reporting of loan activity should be on the same basis as credit subsidy estimates. Statement of Federal Financial Accounting Standards ("SFFAS") No. 2, *"Accounting for Direct Loans and Loan Guarantees"*, was issued in 1993 to provide accounting standards for federal direct loans and loan guarantees that incorporate the CRA's subsidy calculation requirements. With the issuance of SFFAS No. 2, subsidy calculations became important not only for budgetary accounting and reporting purposes but also for financial reporting purposes.

The FCC is in the process of preparing financial statements for the fiscal year ended September 30, 1999 in connection with an upcoming audit. The FCC has tentatively concluded that it will use the hierarchy of accounting principles and standards for Federal agencies as outlined in OMB Bulletin 97-01, *"Form and Content of Agency Financial Statements"*. These accounting principles are detailed in Appendix 1.

SUBSIDY COST ESTIMATES

The Credit Reform Act gives the Office of Management and Budget ("OMB") the responsibility for coordinating and approving subsidy cost estimates. As a general rule, agencies develop discounted cash flow ("DCF") models to estimate the subsidy cost of a "cohort" of loans. A "cohort" is generally defined as all loans approved in a given fiscal year. For a direct loan cohort, a cash flow model projects scheduled payments and any expected deviations from those schedules due to prepayments or defaults. For projected defaults, expected recoveries are also estimated in the cash flow model. Fees generally are the final major cash flow item. Administrative expenses are not included in the cash flow model.

The CRA requires that the expected cash flows be discounted to the point of disbursement at the rate on Treasury securities of comparable maturity. OMB requires that agencies use a uniform discounting tool, known as the OMB Subsidy Model, for discounting the expected cash flows. For a direct loan cohort, if the present value of expected inflows are less than the present value of expected outflows, then the loan cohort has a "subsidy cost", which must be funded using budget authority at the time the loans are obligated. The subsidy cost expressed as a percent of the original loan cohort amount is known as the "subsidy rate". Since the current subsidy cost, or subsidy expense, is \$5.5 billion for the C Block, F Block, SMR, and MDS loan, and the originated loan volume was \$9.5 billion, the current weighted average subsidy rate for all of these loans is 58 percent (\$5.5 billion divided by \$9.5 billion).

SFFAS No. 2 states that agency default estimates consider the following risk factors:

(1) loan performance experience, (2) current and forecasted international, national, or regional economic conditions that may affect the performance of the loans, (3) financial and other relevant characteristics of borrowers, (4) the value of collateral to loan balance, (5) changes in recoverable value of the collateral, and (6) newly developed events that would affect the loans' performance. SFFAS No. 2 also states that "... actual historical experience is a primary factor upon which an estimation of default cost is based".

FCC LOAN VALUATION ISSUES

OMB took an active role in assisting the FCC in developing its original subsidy estimates. Given that the Spectrum Auction installment loan program was a new loan program, no historical data were available to support projections of expected loan performance. While recognizing the differences in the loan programs, OMB determined that the historical performance of loans made through the Small Business Administration's Section 7(a) General Business Loan Guaranty Program provided the best available proxy for the performance of Spectrum Auction loans. Therefore, the default and recovery expectations for the C Block and F Block spectrum auctions loan cohorts were originally based on the historical default and

recovery experience for 7(a) loans made to small businesses in the telecommunications industry. Differences between the SBA and FCC loans include:

- The SBA program requires that 7(a) borrowers demonstrate an ability to repay their loan as a condition for receiving the loan, while the FCC does not.
- The maximum loan size for 7(a) loans is \$1.25 million. The largest FCC loan was for \$895 million.
- The SBA shares 20-25 percent of the credit risk with private lenders. The FCC retains 100 percent of the credit risk.
- The maximum maturity for 7(a) loans is 25 years. The maximum for FCC loans is 10 years.
- New businesses account for approximately 20 percent of 7(a) borrowers, while they account for nearly all FCC borrowers.

Based on the performance of 7(a) loans, OMB projected a 25 percent default rate for Spectrum Auction loan cohorts. A 40 percent recovery rate was estimated for C Block loans, and a 50 percent recovery rate was estimated for F Block loans. Through the reestimate process, the FCC has replaced projected loan performance estimates with actual payment experience. For example, the current C Block subsidy rate reflects actual loan performance through August 1998. The F Block, SMR, and MDS cohorts reflect actual performance through December 1998. Replacing projected default experience with actual performance has generally resulted in an increase in the estimated cumulative (including actual performance and remaining projections) default rate by loan cohort.

SUBSIDY COST ESTIMATION METHODOLOGIES

Current Approach

The FCC and OMB have estimated the subsidy cost of Spectrum Auctions loans using the following approach.

1. Scheduled payments are estimated based on expected loan terms (e.g., maturity, grace periods, interest rate, and payment schedule).
2. Default and recovery rates are projected using the proxy SBA default experience as calculated by OMB.
3. Cohort cash flows are discounted at the projected interest rate during the fiscal year in which the loans will be extended to borrowers.

The CRA requires that agencies annually "reestimate" the prior subsidy cost estimates. As part of this process, Federal credit agencies compare actual to projected performance, update remaining performance projections as warranted, and based on the reestimated subsidy rate, adjust the subsidy expense as needed. For example, when the FY 1997 C Block subsidy rate increased from the original rate of 12.56 percent to the reestimated rate of 61.25 percent, the subsidy expense for this loan cohort increased from \$1.1 billion to \$5.4 billion.

The FCC has used the following methodology for reestimating the subsidy cost of the SMR, MDS, C Block, and F Block Spectrum Auction loans.

1. Replace scheduled payments projected at the cohort level with actual scheduled payments that are calculated at the individual loan level and aggregated up to the cohort level.
2. Adjust scheduled payments for changes in loan terms (due to the 1997-1998 suspension of C Block and F Block payments and the restructuring of C Block loan terms as elected by licensees in June 1998).
3. As actual performance data becomes available, replace projected loan performance with actual loan performance. This includes reflecting the impact of delinquencies, default (including those resulting from bankruptcies), recoveries, and prepayments on expected cash flows.
4. Update the discount rate based on the actual rate at which the FCC borrowed from Treasury to fund each loan cohort.

5. Discount the revised cash flows using the OMB Subsidy Model to determine the subsidy expense that would have originally been recorded if the current information were available at the time the original subsidy estimate was calculated.

The loan performance data used in the subsidy reestimates were taken from the Nortridge Loan System, the FCC's loan servicing system. The FCC has identified potential weaknesses in the quality of the Nortridge data and is currently undertaking a complete review of the data retained in the Nortridge System. If adjustments are required to the Nortridge data, these adjustments will be reflected in future subsidy reestimates.

In the reestimate process, agencies compare actual to projected performance and make adjustments to future performance projections as they deem appropriate. OMB Circular A-34 lists "... such factors as actual experience, new forecasts about future economic conditions, and improvements in the methods used to estimate future cash flows" as justifications for adjusting future expected cash flows.

In its reestimates to date, the FCC has not adjusted its projections of future performance of the outstanding cohorts due to (1) the lack of historical experience on which to base adjustments and (2) concern that changes in projections could result in real cost to the Government.

Unlike large established Federal credit programs, such as the Student Loan Program or SBA's 7(a) program, the FCC does not have an established performance database against which it can compare the performance of its outstanding loan cohorts. For example, the distribution of 7(a) defaults has been consistent across cohorts, regardless of the magnitude of defaults. Therefore, if defaults are higher than originally estimated, then the SBA can expect that this pattern will continue for the remaining life of a given cohort; and, therefore, change its projections for the remaining life of a seasoned loan cohort. No such benchmark exists for the FCC. Therefore, the FCC has been concerned that it does not have a strong foundation for changing its current projects, resulting in new estimates that may be no more accurate than the previous estimate and creating the need for further adjustments in future reestimates. (The second half of this paper examines approaches that could improve upon the FCC's current methodology.)

More importantly, the FCC has expressed concern that adjustments to projected loan performance could negatively impact the Commission's ability to collect on outstanding loans, resulting in *potential* losses becoming *actual* losses. This is of particular concern given the small number of licensees within each cohort. (Ten FCC licensees hold approximately 85 percent of the dollar amount of the FCC's outstanding loan portfolio.) While an increase in projected losses for a cohort of Student Loans could not be reasonably associated with an individual borrower, a change in the projected performance of an existing FCC cohort might be interpreted as the FCC's valuation of a loan(s) to a given licensee or group of licensees. Particularly due to the amount of delinquent debt currently tied up in bankruptcy, FCC and Department of Justice ("DOJ") officials have expressed strong reservations about placing values on individual loans because of the potential effects on the FCC's position in bankruptcy court.

According to FCC management, the DOJ has also expressed reservations about raising default rate expectations and lowering recovery rate expectations in the credit subsidy estimates for budgeting and accounting purposes. These rates are two of the primary variables affecting future performance expectations. While raising the default rate and lowering the recovery rate is not necessarily an admission of diminished expectations on any individual loan, DOJ believes adjusting these estimated rates may affect the position of the FCC in bankruptcy proceedings. These considerations may reduce the flexibility of the FCC in determining an approach for assessing the collectibility of its outstanding installment loan portfolio.

BANKRUPTCY

An estimated \$6.8 billion of the outstanding Spectrum Auction installment loan balances are tied up in bankruptcy. This amount represents approximately 77% of the total current outstanding installment loan balance. We understand the Commission is currently seeking assistance from Congress to clarify that FCC licensees who default on their installment payments may not use bankruptcy litigation to avoid the automatic cancellation of their spectrum licenses. A number of FCC licensees have argued that, even if they default on their installment payments the licenses do not automatically cancel and the Commission cannot auction new licenses for the

same spectrum while bankruptcy litigation is pending. Thus far, court decisions have favored the licensees. In the absence of clarifying legislation, there is a risk that valuable spectrum licenses will be tied up in litigation, delaying the cancellation of the debtor's licenses and the subsequent auction of new licenses, the introduction of new services and competition, and the collection of revenues.

Two bankrupt licensees, NextWave and GWI, have successfully avoided partial (80 – 85%) repayment of their obligations arguing that during the length of time it took for the FCC to grant their licenses, the value of the licenses depreciated to a less than reasonable equivalent value in exchange for the obligation incurred at licensing. While the FCC is appealing these decisions, several other licensees have filed for bankruptcy by piggy-backing off the legal strategy successfully argued by NextWave and GWI.

To estimate the value of the outstanding installment loans in bankruptcy (approximately 77% of the portfolio), assumptions need to be made regarding the potential resolution of the pending bankruptcy litigation. For credit subsidy estimate and re-estimate purposes, the FCC assumes that on average 40% of the principal balance of C Block loans and 50% of SMR, MDS, and F Block loans in default will be recovered after the default through cancellation of the license and subsequent auction of the new license. However, based on most recent actual experience, it appears that not all loans in bankruptcy may result in recovery. For example, certain licensees have had their debt reduced by the bankruptcy courts to as little as 16% of the original obligation. As a result, these licensees may have an easier time securing capital and meeting their reduced obligation to the FCC. Assuming the bankrupt licensees restructure successfully in bankruptcy, the FCC may only recover 15 to 20% of the original principal balance, based on the results of the NextWave and GWI cases, not the average 40% and 50% assumed in the current credit subsidy estimate assumptions.

However, the FCC is appealing these decisions and litigation is on-going. The outcome is not clear, and the FCC has not yet revised its assumptions to reflect changed expectations about the outcome.

REFINING CREDIT LOSS ASSUMPTIONS

As a general rule, a Federal lending agency's collectibility assessment should be directly tied to its subsidy expense. Changes in collectibility expectations are incorporated into the subsidy expense through the annual reestimate process. Increased collectibility expectations would result in a decrease in the subsidy expense of direct loan cohorts, reflecting the agency's expectation that collections will be greater than previously projected. Decreased collectibility (either due to an increase in expected defaults or a reduction in recovery expectations) increases the subsidy expense. In many cases, agencies have not linked collectibility assessment and subsidy reestimates because these processes have not been coordinated within the agency. Occasionally, agencies have intentionally not linked the two processes due to their concern that this could have a negative impact on collectibility. OMB has worked with credit agencies to ensure that the subsidy reestimate process does not result in unnecessary costs to the Government.

A collectibility assessment feeds into the credit subsidy cost estimate through the default rate and recovery rate. The default rate is the estimated percentage of the loan amount at origination that will default over the active life of the loan cohort. The recovery rate is the estimated percentage of the estimated defaulted amount that will be recovered.

The FCC could consider a range of approaches for improving its collectibility assessments. In order to improve its ability to assess collectibility, the FCC may want to undertake individual borrower credit risk analysis and collateral valuation. The largest 10 borrowers of approximately 400 total borrowers, hold over 200 licenses and make up approximately 85% of the total outstanding principal balance of the installment loan portfolio. These licensees represent the largest performance risk exposure to the portfolio. According to SFFAS No. 2, "If individual accounts with significant amounts carry a high weight in risk exposure, an analysis of the individual accounts is warranted in making the default cost estimate for that category." If feasible with other Commission legal, accounting, regulatory, and political considerations, the FCC should consider an individual analysis of its largest accounts when making default and recovery estimates.

Any analysis undertaken should be consistent with guidance and requirements of Federal agencies. SFFAS No. 2 states that agencies consider the following risk factors when estimating default costs: (1) loan performance experience, (2) current and forecasted international, national, or regional economic conditions that may affect the performance of the loans, (3) financial and other relevant characteristics of borrowers, (4) the value of collateral to loan balance, (5) changes in recoverable value of the collateral, and (6) newly developed events that would affect the loans' performance.

(1) Loan performance experience

In estimating default cost, an analysis should be performed on borrower payment history. This information can be obtained from the Nortridge Loan System, although some concern has been raised by FCC officials regarding the quality of the data. The analysis should consider the number of times a borrower has missed a payment, made a partial payment, or made a prepayment. It should also consider the timing of those payments. The FCC's current subsidy reestimates reflect actual payment experience.

(2) Current and forecasted international, national, or regional economic conditions that may affect the performance of the loans

In estimating default cost, an analysis should consider those market factors that may affect a borrower's ability to pay. Spectrum Auction installment loans were granted to small, start-up, wireless telecommunications companies. One of the biggest factors determining a licensee's ability to pay is its access to capital. Because of the high expense of the equipment required, and the absence of income during the construction process, the "build-out" of wireless systems is very capital intensive, and must be financed in anticipation of future revenues to be earned after the infrastructure has been built and the spectrum license has been put in use.

A borrower's current and future ability to obtain financing is a function of many exogenous economic and market variables including, but not limited to:

- The market perception of a borrower's cost structure and debt burden incurred through purchase of spectrum licenses.
- Trends in interest rates and telecommunications equity prices.
- The current and future wireless telecommunications industry characteristics including (1) prospects for growth, stability, or decline, (2) pattern of business cycles, (3) vulnerability to technological change, labor unrest, or regulatory interference, and (4) demand growth, ability to maintain margins, flexibility in timing of capital outlays, and capital intensity.
- The nature of competition within the industry including (1) whether competition is increasing or decreasing, (2) basis of competition (i.e. price, quality of product, product differentiation, image, service, or other factors), and (3) whether competition is local, regional, national, or global.

(3) Financial and other relevant characteristics of borrowers

In estimating default risk and loss given default, the FCC should consider borrower specific factors that may affect its ability to pay. These factors include business and financial risk factors. An evaluation of business risk factors should include an examination of the borrower's competitive position. This would begin with an understanding of the basis of competition in the industry. The analysis should then examine the competitive position of the borrower in critical business areas including, but not limited to technology, operating efficiency, position in specific markets, marketing prowess, and market penetration. The analysis of business risk factors should also include an evaluation of borrower management, including its track record, financial policy, and its strategies.

An evaluation of financial risk factors should include an examination of the financial characteristics of the borrower including, but not limited to capital structure, cost position, cost control, average revenue per user, capital expenditures, and percentage of sequential revenue growth falling to EBITDA line.

(4) Value of collateral to loan balance; (5) Changes in recoverable value of collateral

A methodology for determining the value of license to loan balance would be an analysis of FCC auctions of licenses canceled through default which are currently underway. As of April 1999, 302 new licenses from the cancellation of defaulted C, E, and F block licenses had been subsequently auctioned. While a comparable license will not be available in every market, the differences in the licenses can be reflected by appropriate adjustments to the price of the comparable license.

According to auction bidders, the value of the spectrum license is a function of several factors including, but not limited to:

1. Number of people in the Basic Trading Area ("BTA") or Metropolitan Trading Area ("MTA")
2. Carrying capacity of the license being auctioned
3. Population density on a per square mile basis
4. Comparable licenses sold in that market

Using these factors, comparable licenses could be determined and adjustments made to price accordingly.

For example, a licensee holding a loan with a principal balance of \$20,000,000 financing a license in St. Louis, MO, is expected to default. To determine the recovery rate for this loan, first determine if a St. Louis license has recently been sold. If yes, then this license is a sales comparable for that market. If no license in St. Louis has traded recently, then determine other comparables based on similar market characteristics. For example, if St. Louis has a population of 500,000 and a population density of 150, then licenses which recently were auctioned in Kansas City (population of 600,000 and density of 170) and Memphis (population of 450,000 and density of 120) may be good comparables. Adjustments would be made to reflect the difference in population and density. In addition, if the St. Louis license being auctioned is a 30 MHz license, the Kansas City license was 15 MHz, and Memphis was 10 MHz, an adjustment would need to be made for the carrying capacity of the license.

The result of this analysis could produce a “\$ per pop” (dollar per person in the market) value of the license. Thus if the analysis determines an adjusted \$ per pop value for Kansas City of 9 dollars and 7 dollars for Memphis, the average of the two sales comparables, 8 dollars, would be the expected \$ per pop value of the St. Louis license. Multiplying \$8 times the population of St. Louis, the concluded expected value of the license would be \$4,000,000. The recovery rate for this loan would then be \$4 million divided by \$20 million (outstanding principal) or 20%.

If this analysis was performed for each license in the installment loan portfolio, a weighted average recovery rate could be determined. This recovery rate may be more accurate and predictive than the estimate provided by OMB based on a sample of SBA loans to wireless companies.

(6) Newly developed events that would affect loan performance

In estimating default costs, the FCC should consider other current and future events that may affect loan performance. The largest issue affecting the performance of the installment loan portfolio has been the introduction of bankruptcy as a means of avoiding partial payment of the loan obligation. For an accurate assessment of collectibility for these loans, assumptions must be made regarding the future outcome of the litigation and restructuring. Currently, credit subsidy estimates assume that all debt in bankruptcy is in default and on average 40% to 50% of the principal balance is recovered. This assessment accounts for only one possible outcome of the loans in bankruptcy.

One FCC borrower currently in bankruptcy is NextWave. In a recent court decision, this licensee successfully avoided \$3.7 billion in outstanding debt to the FCC. The remaining obligation to the FCC is \$549 million. The FCC is currently appealing this court decision. The pending litigation and uncertainty regarding the amount makes it difficult to project future cash flows. We understand from FCC management that there are potentially at least four possible outcomes to the NextWave bankruptcy case.

1. Upon appeal, the appellate courts will uphold the decision of the lower court. The reduced debt burden on NextWave will draw capital to the company. NextWave will successfully build-out its PCS systems and repay its reduced obligation of \$549 million to the FCC. Under this scenario, the FCC would only recover approximately 20% of the original principal balance.
2. Upon appeal, the appellate court will uphold the decision of the lower court. Even with the reduced debt burden, NextWave still is unsuccessful in securing financing, is unable to build-out its PCS systems and repay its reduced obligation to the FCC. The Commission will cancel NextWave's licenses and subsequently auction new licenses at current market prices. Under this scenario, the FCC would recover the market value of the new licenses auctioned.
3. Upon appeal, the appellate courts will reverse the decision of the lower court or Congress will pass clarifying legislation stipulating that licensees can not use bankruptcy to avoid the automatic cancellation of licenses. In this case, the original obligation of approximately \$4.7 billion will be upheld, NextWave will continue to be unable to meet its obligation to the FCC, the FCC will cancel NextWave's licenses and subsequently auction new licenses at current market prices. Under this scenario, the FCC would recover the market value of the new licenses auctioned.
4. Upon appeal, the appellate courts will reverse the decision of the lower court or Congress will pass clarifying legislation stipulating that licensees can not use bankruptcy to avoid the automatic cancellation of licenses by the FCC. In this scenario, the original obligation of approximately \$4.7 billion will be upheld, and NextWave is able to fully repay its debt.

According to FCC management, the recovery on these loans could potentially range between 20% and 100%, depending on the outcome of the pending bankruptcy litigation. A methodology should be used to value these loans that would consider these different scenarios.

NEXT STEPS

Current budgeting and accounting guidelines provide a range of discretion with respect to how an agency determines the collectibility of its delinquent debt, and the CRA gives OMB the responsibility for coordinating and approving an agency's subsidy estimates. The FCC's current approach, as well as the methodology outlined above for improving future performance assumptions, should assist the FCC in complying with current budgeting and accounting requirements. Although some approaches may result in more detailed collectibility estimates than others, these approaches may give rise to certain risks and costs that should be carefully weighed against the benefits of reflecting these assessments in the subsidy estimates before a final determination is made. The FCC Office of Inspector General, Office of Managing Director, Wireless Telecommunications Bureau, and Office of General Counsel should work together with OMB and DOJ in developing an approach to determining the collectibility of the FCC's non-tax delinquent debt that is consistent with Federal accounting and reporting practices, but feasible with all of the accounting, legal, and political issues surrounding the Spectrum Auction installment portfolio. This process should start with developing a consensus among all affected parties regarding the goals and acceptable risks and costs of the approaches outlined in this paper. The parties involved in deciding on the most suitable approach should concentrate on how to improve future performance assumptions, without undermining debt collection efforts, using the options outlined above.

APPENDIX 1

Federal Government Loan Accounting Requirements

The accounting principles and reporting objectives established for the Federal government include the following requirements regarding the assessment of loan receivables:

- Federal Accounting Standards and Advisory Board ("FASAB") Statement of Federal Financial Accounting Standards (SFFAS) No. 2
 - ⇒ Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance.
 - ⇒ A subsidy expense is recognized for loans disbursed during a fiscal year. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows.
 - ⇒ The subsidy cost allowance for direct loans are reestimated each year, taking into account all factors that may have affected the estimated cash flows. Any adjustment resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense.)
 - ⇒ When direct loans are modified, the cost of modification is recognized at an amount equal to the decrease in the present value of the direct loans or the increase in the present value of the loan guarantee liabilities measured at the time of modification.
 - ⇒ Upon foreclosure of direct loans, the acquired property is recognized as an asset at the present value of its estimated future net cash inflows.
 - ⇒ Direct loans obligated and loan guarantees committed after September 30, 1991, must be accounted for on a present value basis, which is consistent with the intent of the Federal Credit Reform Act of 1990.

- SFFAS No. 2 has an amendment pending which would add the following reporting requirements:
 - ⇒ Reporting subsidy reestimates in two distinct components: the interest rate reestimate, and the technical/default reestimate.
 - ⇒ Reconciling the beginning and the ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees, reported in an entity's balance sheet.
 - ⇒ Providing a description of program characteristics and disclosure for (1) the amounts of direct or guaranteed loans disbursed in each program during the reporting year, (2) the estimated subsidy rates for the total subsidy and the subsidy components at the program level in the current year's budget for the current year's cohorts, and (3) events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have had a significant impact on subsidy rates, subsidy expense, and subsidy reestimates, and (4) events and changes in conditions that have occurred and are more likely than not to have a significant impact but the effects of which are not determinable at the reporting date.



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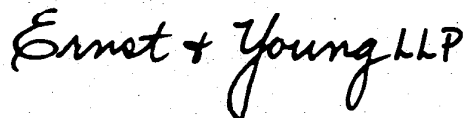
PCIE/ECIE REVIEW OF NON-TAX DELINQUENT DEBT
FOR THE FEDERAL COMMUNICATIONS COMMISSION

PERFORMANCE REVIEW GUIDE
RESULTS TO DATE

JUNE 18, 1999

Office of Inspector General
Federal Communications Commission
445 12th St., S.W.
Washington, D.C. 20554

This document is provided as part of our consulting services conducted for the Federal Communications Commission ("FCC" or "Commission") Office of the Inspector General ("OIG") under Purchase Order P995402039. Pursuant to our statement of work, this document summarizes the results to date of relevant portions of the Performance Review Guide, published by the Department of Treasury Office of the Inspector General, ("Review Guide") related to the Federal government-wide President's Council on Integrity and Efficiency ("PCIE") Review of Non-Tax Delinquent Debt ("PCIE Review"). We accept no responsibility to update or revise this document for events that occur or new information that becomes available subsequent to the date of this document.



June 18, 1999

PCIE PERFORMANCE REVIEW GUIDE – RESULTS TO DATE

TABLE OF CONTENTS

Executive Summary	1
General Background.....	4
Debt Management Activities.....	7
• Review Objectives	7
• Collection Activities	7
⇒ C Block Installment Loan Restructuring.....	9
• Loss Prevention Activities	13
⇒ Assessment of Delinquent Debt.....	16
Documenting and Classifying Delinquent Debt	18
• Review Objectives	18
• Documentation	18
• Classification	20
Accounts Receivable	21
• Review Objectives	21
• Existence of Accounts Receivable.....	22
• Collectibility	24
• Revenue Recognition	29
Appendix 1: Notes Regarding Estimation of Delinquent Debt.....	31
Appendix 2: Past Due Report from Nortridge Loan Tracking System	33
Appendix 3: Summary of Trial Balance As of March 31,1999 from Nortridge System	34
Appendix 4: Reconciliation of Receivables As of September 30, 1998	35
Appendix 5: Summary of Report of Receivables from Public as of September 30, 1998	36

EXECUTIVE SUMMARY

This document is provided as part of our consulting services conducted for the Federal Communications Commission ("FCC" or "Commission") Office of the Inspector General ("OIG") under Purchase Order P995402039. Pursuant to our statement of work, this document summarizes the results to date of relevant portions of the Performance Review Guide, published by the Department of Treasury Office of the Inspector General, ("Review Guide") related to the Federal government-wide President's Council on Integrity and Efficiency ("PCIE") Review of Non-Tax Delinquent Debt ("PCIE Review").

The primary objectives of the Government-wide PCIE Review are to (1) determine whether previously reported amounts of Federal government-wide non-tax delinquent debt accurately represent the universe of non-tax delinquent debt, and (2) to attempt to assess the collectibility of the delinquent debt. To accomplish the objectives of the PCIE Review, Federal agencies are to: (1) compare agency performance to the provisions of the Debt Collection Improvement Act of 1996 ("the DCIA"), (2) trace recorded receivable amounts to source records, (3) evaluate aging and collectibility of accounts receivable, and (4) if applicable, examine procedures used to resolve portfolios returned by the Department of Treasury to the individual agency as not ready for collection. The Review Guide was designed as a tool to provide background information and general guidance in assisting agencies to accomplish the objectives of the overall PCIE Review.

Our consulting services were performed to assist the FCC OIG in its assessment of the FCC's Spectrum Auction installment debt management practices. Our work was conducted in accordance with consulting standards of the American Institute of Certified Public Accountants and did not constitute an audit or any other form of assurance on any financial information or debt management practices of the FCC. In performing this task, interviews were conducted and documentation researched to obtain a general understanding of the FCC's Spectrum Auction installment debt collection procedures. Various relevant regulatory guidance was also reviewed. This project is one of several consulting projects we are performing for the FCC on a variety of debt portfolio-related matters.

The accompanying information represents the results of the Review Guide that were able to be completed as of the date of this document. The Review Guide contains steps to evaluate the probability of collection of agency receivables. Because the FCC has not yet made an overall financial assessment of the collectibility of its Spectrum Auction installment loan portfolio, the portions of the Review Guide related to assessing the collectibility of the FCC's installment loan portfolio have not been completed at this time. We will provide in a separate document, observations and recommendations to assist the FCC to develop an approach for evaluating the collectibility of non-tax delinquent debt.

In addition, the Review Guide contains steps to evaluate whether adequate steps are taken to ensure that delinquent debt is referred to FMS. According to the DCIA, a creditor agency is not required to transfer a debt to FMS if the debt is in litigation or foreclosure. The FCC anticipates that proceeds will be available from the subsequent auction of the new license for application to the installment debt. As such, the FCC has not transferred any of its installment loans to FMS for collection since the installment loans, in their current status, do not meet the requirements for

referral under the DCIA. As such, no findings are applicable for these sections of the Review Guide.

The Review Guide also contains steps to trace summary loan information to original loan documents. No procedures were performed in connection with the preparation of this Review Guide to test the reliability of the Nortridge System installment loan information or the availability of original loan documentation. However, loan file documentation was obtained and reviewed in connection with the FCC's Loan Auditability project being conducted by the FCC's Financial Operations Division and Wireless Telecommunications Bureau.

As requested by the FCC OIG, this document focuses only on the FCC's Spectrum Auction installment loan program. When a reference is made to FCC "debt" and/or "loans", it is meant to refer to the receivables resulting from the auction installment loan program. This document assumes the FCC has a secured interest in the license associated with an installment loan and that upon default, a new license related to the same service and market of the canceled license can be subsequently auctioned with the proceeds raised applied to the outstanding loan amount of the defaulted debtor.

The FCC is currently experiencing significant collection issues with its Spectrum Auction installment loan portfolio. Based on the unaudited March 31, 1999 Trial Balance from the Nortridge Loan Tracking System, the FCC had 1,774 loans outstanding to approximately 400 borrowers. Of these 400 borrowers, approximately 180 borrowers were delinquent on at least one installment loan. Of the approximately \$8.8 billion in estimated outstanding principal as of March 31, 1999, approximately \$7.0 billion (80%) is delinquent. The amount of delinquent debt reflects the entire outstanding principal balance for those loans with a delinquent installment payment, not just the past due portion of the debt (see Note on Page 17 for additional information). Of this amount, almost \$6.8 billion is tied up in various licensee bankruptcy proceedings. Approximately \$6.6 billion of this amount is attributable to three C block borrowers that have multiple individual loans. (These amounts were derived from unaudited sources including the Nortridge Loan Tracking System and spreadsheets obtained from Wireless Telecommunications Bureau and Financial Operations Division officials). FCC management has stated that the Office of the General Counsel of the FCC together with the Department of Justice are vigorously litigating bankruptcy cases to recover FCC licenses. For the Office of Management and Budget ("OMB") credit subsidy estimate and re-estimate purposes, the Commission has obligated budget authority equal to approximately \$5.4 billion, or approximately 60% of the face amount of its C and F block installment loans to cover potential losses on these portfolios.

Based on discussions with FCC management and other information obtained, the high level of FCC's delinquent debt is due to a number of contributing factors including, but not limited to, balancing program social goals with the need for front-end loan underwriting, changes in market conditions, and inability of licensees to raise additional capital. The FCC's collection efforts have also been hampered by various internal and external accounting and organizational problems, such as:

- unclear and undefined internal FCC debt collection policies, procedures and responsibilities;
- non-performance of certain debt collection activities;
- insufficient reporting and monitoring of installment loan portfolio performance; and
- difficulties and problems with the outsourced Nortridge Loan Tracking System.

To address the current situation, the FCC is taking steps to improve debt management practices, including defining the bureaus and offices responsible for collection actions as well as formalizing and documenting debt management policies and procedures. It is also transferring loan servicing and collection responsibilities from Treasury's Financial Management Service ("FMS") to the FCC's Credit and Debt Management Center ("CDMC") in Washington, D.C. The FCC is also adding additional finance and accounting staff to increase its internal loan servicing and debt management capabilities and resources. These steps are being taken to ensure better internal controls, consistency in processing standards, compliance with Federal laws and regulations, and better protection of the financial assets of the Federal government.

GENERAL BACKGROUND

According to FCC management, the FCC has awarded over 7,500 licenses to auction winners who are either offering or preparing to offer services to the public in nine different wireless and satellite categories. Many of these auction winners have participated in the installment loan program. Winning net bids in FCC spectrum auctions totaled over \$23 billion, with over \$13 billion of this amount collected for the U.S. Treasury to date.

The installment payment program of the FCC was established to enable businesses to pay for spectrum licenses that might otherwise not be able to acquire licenses through the FCC's auction process. The Telecommunications Act of 1996 ("the Act") mandates the FCC to promote "economic opportunity and competition and ensure that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women."

To accomplish the objectives of the Act, the FCC was granted authority to "consider alternative payment schedules and methods of calculation, including lump sums or guaranteed installment payments." The FCC decided to provide installment financing in seven of its spectrum auctions, including the broadband Personal Communications Services ("PCS") C and F blocks, the narrowband PCS, Interactive Video and Data Service ("IVDS"), Multipoint Distribution Service ("MDS"), and 900MHz Specialized Mobile Radio ("SMR"). Installment payments were first offered in 1994 in the IVDS auction.

Under the installment financing program, winning bidders were generally given five to ten years to repay their bid amount (net of a 10% to 20% required down payment) in quarterly installment payments with up to six-year interest-only payment periods at the beginning of the loan term. Interest rates generally varied between 6% and 9.5%, well below market rates, depending on the type of borrower.

Over 95% of the Spectrum Auction winners who were eligible for the installment payment program participated in it. FCC management stated it believes that the installment payment program furthered the Congressional mandate to provide opportunities for designated entities. The FCC also believes these payments placed it in the role of being both a regulator and a lender to the wireless industry it licenses.

As requested by the Inspector General of the Federal Communications Commission, this document focuses only on the FCC's Spectrum Auction installment loan program. When a reference is made to FCC "debt" and/or "loans", it is meant to refer to the receivables resulting from the auction installment loan program. This document assumes the FCC has a secured interest in the license associated with an installment loan and that upon default, a new license related to the same service and market of the canceled license can be subsequently auctioned with the proceeds raised applied to the outstanding loan amount of the defaulted debtor.

In performing our procedures, key FCC staff and contractors involved in FCC's spectrum auction installment loan program were interviewed based on the list of questions contained in the Performance Review Guide for the President's Council on Integrity and Efficiency's ("PCIE")

"Review of Non-Tax Delinquent Debt" published by the Department of Treasury Office of Inspector General ("Review Guide"). Within the FCC, officials in the Auctions Division of the Wireless Telecommunications Bureau ("WTB"), the Financial Operations Division of the Office of the Managing Director ("OMD"), and the Office of the General Counsel ("OGC") were interviewed. Also, various FCC contractors and contractors at the Financial Management Service ("FMS") of the Department of Treasury ("Treasury") were interviewed.

In addition, Treasury and other non-FCC staff with knowledge of and responsibility for overseeing and implementing the FCC's debt collection activities, or collecting FCC's delinquent debt were interviewed. Various accounting and finance data and background material were gathered from the FCC regarding its installment loans and debt management practices and considered in performing our work.

The FCC is currently experiencing significant collection issues with its installment loan portfolio. Based on the unaudited March 31, 1999 Trial Balance from the Nortridge Loan Tracking System, the FCC had 1,774 loans outstanding to approximately 400 borrowers. Of these 400 borrowers, approximately 180 borrowers were delinquent on at least one installment loan. Of the approximately \$8.8 billion in outstanding principal as of March 31, 1999, approximately \$7.0 billion (80%) is delinquent. The amount of delinquent debt reflects the entire outstanding principal balance for those loans with a delinquent installment payment, not just the past due portion of the debt (see Note on Page 17 for additional information). Of this amount, almost \$6.8 billion is tied up in various licensee bankruptcy proceedings. Approximately \$6.6 billion of this amount is attributable to three C block borrowers. (These amounts were derived from unaudited sources including the Nortridge Loan Tracking System and spreadsheets obtained from Wireless Telecommunications Bureau and Financial Operations Division officials). FCC management has stated that the Office of the General Counsel of the FCC together with the Department of Justice are vigorously litigating bankruptcy cases to recover FCC licenses. For OMB credit subsidy estimate and re-estimate purposes, the Commission has obligated budget authority equal to approximately \$5.4 billion, or approximately 60% of the face amount of its C and F block installment loans to cover potential losses on these portfolios.

The C block auction closed about six months before the drop (during winter of 1996) in telecommunications company stock prices. This decline in the telecommunications market made it difficult for some borrowers to raise equity capital for their businesses. According to FCC management, these borrowers paid on average three times more for their licenses than licensees in auctions where installment payment programs were not offered. According to published articles, many of these borrowers believed the premiums were justified when the generous financing terms of the government were considered.

Based on discussions with FCC management, other factors contributing to the level of delinquent installment debt include, but are not limited to:

- lack of borrower credit quality requirements and limited front-end controls employed by the FCC in making installment loans;
- generous financing terms which may have increased the price of spectrum licenses;

- Wall Street investors who did not follow through on plans to provide credit to small licensees; and
- Global changes in capital markets affecting everyone, especially small businesses (see page 9.)

Based on discussions with FCC management, the FCC's collection efforts have also been hampered by various internal and external accounting and organizational problems, such as:

- unclear and undefined internal FCC debt collection policies, procedures and responsibilities;
- non-performance of certain debt collection activities;
- insufficient reporting and monitoring of installment loan portfolio performance; and
- difficulties and problems with the outsourced Nortridge Loan Tracking System.

To address the current situation, the FCC is taking steps to improve debt management practices, including defining the bureaus and offices responsible for collection actions as well as formalizing and documenting debt management policies and procedures. It is also transferring loan servicing and collection responsibilities from FMS to the FCC's CDMC in Washington, D.C. The FCC is also adding additional finance and accounting staff to increase its internal loan servicing and debt management capabilities and resources. These steps are being taken to ensure better internal controls, consistency in processing standards, compliance with Federal laws and regulations, and better protection of the financial assets of the Federal government.

The following sections contain a reproduced copy of the Review Guide along with related results to date as applicable.

I. DEBT MANAGEMENT ACTIVITIES

Review Objectives:

- A. Collection - To determine whether the agency is aggressively pursuing the collection of non-tax delinquent debt.
- B. Loss Prevention - To determine whether program agencies are reducing losses by providing adequate debt management.

Collection Activities

- 1. Determine the procedures used by the program to collect the non-tax delinquent debt before it is referred to Financial Management Service for collection.
 - a. *Does the agency contact the debtor once the auction installment debt becomes 30 days delinquent via a demand letter?*

Observations:	<p>FCC does not contact the debtor once the debt becomes 30 days delinquent via a demand letter. However, licensees are notified upon receiving their next quarterly statement that they are past due.</p> <p>The FCC maintains a loan servicing agreement with the Financial Management Service ("FMS") of the U.S. Department of Treasury. According to a Memorandum of Understanding ("MOU") signed June 28, 1996, FMS is responsible, among other things, for sending a demand letter for the amount of the total obligation including principal, interest, and any collection or administrative fees and expenses on the 10th calendar day after they notify the FCC of the delinquency. According to FCC management and FMS officials, FMS has not performed these activities.</p> <p>The Auctions Division of the Wireless Telecommunications Bureau is in the process of sending letters to borrowers who are delinquent under the old installment payment rules (prior to 3/16/98). Under these rules, a borrower who missed an installment payment had 90 days to apply for a grace period of up to 180 days. If the borrower did not file a grace period request, they would be in default after 90 days and subject to cancellation of their licenses. These rules have since been amended.</p> <p>Of the approximately 20 licensees who became delinquent under the old installment payment rules, three have been sent letters as of April 15, 1999. The Wireless Telecommunications Bureau is currently drafting</p>
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	letters to the other borrowers. These letters inform the borrowers that they are delinquent, will be charged a late fee, and must bring themselves current or their license will be canceled.
<i>Sources:</i>	<ul style="list-style-type: none"> • Memorandum of Understanding between U.S. Department of the Treasury Financial Management Service and Federal Communications Commission, June 28, 1996 • Interview of Wireless Telecommunications Bureau officials

b. Does the agency attempt to establish debt restructuring to facilitate repayment?

<i>Observations:</i>	<p>The FCC has attempted to restructure some of its delinquent installment loans. For example, C block licensees, who experienced financial difficulties, were given an option plan allowing them to prepay or return all or some of their licenses in return for debt forgiveness. The options the Commission offered were meant to provide limited relief to these licensees while preserving the integrity of the auction process.</p> <p>See <i>C-Block Installment Loan Restructuring Discussion</i> below.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • C block election schedule provided by Auctions Division of the Wireless Telecommunications Bureau. • <i>Order on Reconsideration of the Second Report and Order</i>; FCC 98-46; Released March 24, 1998. • <i>Order</i>; FCC 98-290; Released October 29, 1998. • <i>Second Order on Reconsideration of the Second Report and Order</i>; FCC 99-66; Released April 5, 1999. • Interview of Wireless Telecommunications Bureau officials • "FCC may reopen license bids: New wireless phone license auction would cause uproar", by Richard Waters, <i>The Financial Times Limited</i>, September 2, 1997. • "U.S. wireless firms get relief: FCC offers cash-strapped companies payment options for cellular licenses", by Jeff Vinson and Andrew Brooks; Bloomberg News; <i>The Gazette (Montreal)</i>, September 26, 1997. • "Hollow Victory", by Peter Spiegel, <i>Forbes</i>, January 27, 1997.

c. Has the agency attempted to garnish the pay of delinquent debtors?

<i>Observations:</i>	<p>The FCC has not attempted to garnish the pay of delinquent installment loan debtors. Wage garnishment may not be an effective debt collection tool for the FCC because very few licenses have been granted to individuals.</p>
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<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of Wireless Telecommunications Bureau officials
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d. Has the agency attempted the sale of installment debt more than 90 days delinquent?

<i>Observations:</i>	<p>The FCC has not attempted the sale of debt more than 90 days delinquent.</p> <p>The FCC considered the sale of its debt in 1996, but concluded this was an ineffective debt collection tool. Because the authority over the license remains with the FCC, the Commission would effectively be selling unsecured debt. FCC management indicated such sales would not maximize the recovery to the Federal government.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of Wireless Telecommunications Bureau officials

e. Has the agency granted compromise authority on installment debts, especially older installment debts?

<i>Observations:</i>	<p>The FCC has not used compromise authority as a means of resolving delinquent debt; however a compromise request is currently under consideration.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of Wireless Telecommunications Bureau officials

C-Block Installment Loan Restructuring

Background

According to Commission records, in early 1997, nine broadband PCS C block licensees participating in the installment payment program indicated that they were having difficulty making their installment payments and requested that the Commission amend the terms of the installment payment program for broadband PCS services. The licensees blamed increased competition and changing market conditions (i.e. decline in financial markets, lower bid prices in the broadband PCS F block and WCS auctions) for their financial difficulties.

In order to fully consider the licensee's proposals, on March 31, 1997, the Wireless Telecommunications Bureau suspended installment payments for all C and F block licenses. The Bureau issued a public notice requesting comments on broadband PCS installment payments, and hosted a public forum attended by over 150 licensees and representatives from the wireless industry and financial markets.

In response, the Commission approved an option plan on September 25, 1997 for broadband PCS C block licensees and indicated it would reinstate the installment payment deadline for PCS C and F block licensees as of March 31, 1998. The deadline for submitting elections and the reinstatement of payments was delayed several times due to the large number of petitions for reconsideration and the need to address the issues raised by the petitioners. The deadline for electing an option was moved from January 15, 1998 to June 8, 1998 and the date to resume payments was pushed from March 31, 1998 to July 31, 1998. Licensees that did not make a payment on July 31, 1998 had 90 days (October 29, 1998) to make their first installment payment with a 5% late fee, otherwise the license would automatically cancel.

C block licensees not resuming original installment payments could elect one of three options:

1. **Prepayment:** A licensee could purchase any of its licenses at the face value of the outstanding debt on those licenses. A licensee had to purchase all or none of the licenses it owned within any single Metropolitan Trading Area ("MTA"). A licensee could use up to 70% of its down payment on licenses from other MTAs that it did not wish to retain as a credit towards prepaying those licenses that it wished to keep. Licenses relinquished in accordance with this option had to be surrendered to the FCC for subsequent auction. A licensee electing this option (and its affiliates) could not bid at the subsequent auction for any of the new licenses and could not otherwise acquire any such license in the secondary market for a period of two years.
2. **Amnesty:** The licensee could return to the Commission any of its licenses so long as all licenses within an MTA were returned. The entire outstanding debt on returned licenses would be forgiven. For licenses that were returned, the licensee had two choices: (a) the licensee could opt to bid on those licenses in the subsequent auction; or (b) the licensee could opt to forgo the opportunity to bid in exchange for a credit of 70% of the down payment already made on the returned licenses. The same choice had to be made for all licenses within an MTA. The 70% credit had to be used to prepay either 30MHz or 15MHz disaggregated licenses retained by the licensee.
3. **Disaggregation:** A licensee could disaggregate all of its 30MHz licenses within an MTA and return 15MHz to the Commission in exchange for forgiveness of 50% of the outstanding debt. For licensees who elected to disaggregate, there were two options, resume payments on the disaggregated license under the terms of the installment payment plan or prepay the outstanding loan balance on the disaggregated license. A licensee who elected to continue installment payments for the disaggregated license would receive a total credit equal to 70% of the original down payment made on the 30MHz disaggregated license. In receiving forgiveness of 50% of the outstanding debt, the licensee retains the benefit of 50% of the original down payment. In addition, 40% of the down payment associated with the disaggregated spectrum that was returned to the Commission (or 20% of the original down payment) would be used to prepay Suspension Interest or reduce principal at the licensee's option. For licensees who elected to prepay outstanding debt on the disaggregated license, the licensee would receive a credit equal to 85% of the original down payment made on the 30MHz disaggregated license. This credit represents 70% of the down payment associated with the 15MHz returned spectrum (or 35% of the original down payment), plus 100% of the

down payment associated with the 15 MHz of retained spectrum (or 50% of the original down payment).

From the licensee's perspective, four options were available to them. Licensees, who believed the three options offered by the Commission did not provide sufficient financial relief, could file for bankruptcy in an effort to restructure their business and protect their assets.

In response to the options made available by the Commission, General Wireless, a licensee representing almost \$1 billion in outstanding debt (almost 12% of total outstanding C block debt) stated in published articles, "We're disappointed ... it [the Commission Orders] probably does not provide a viable alternative to bankruptcy." NextWave, representing about \$4.3 billion in outstanding debt (almost 50% of total outstanding C block debt), also rejected the restructure options. They stated in published articles that the option plan "isn't commercially reasonable, and it's unnecessarily punitive."

The option plan also drew criticism from members of Congress. Some members of the House Commerce Telecommunications subcommittee supported discounts for C block licensees that the chairman of the committee, Rep. Billy Tauzin, stated in published articles would have "protected the government's financial interest, but also presented the affected companies with ways to avoid bankruptcy."

The Commission defends its restructure options by stating the array of choices was intended to provide only *limited* relief to financially troubled licensees without harming the integrity of the auction process.

Restructure Results

FCC management has stated it is in the position of being a promoter of program goals, a regulator and a creditor to its licensees. As a result, there is more than one way to evaluate the success of the C block elections. **Consistent with objectives of the PCIE Review of Federal non-tax delinquent debt, the C block restructuring is discussed below in terms of its effectiveness as a debt collection tool and not in terms of program goals.** In addition, since certain licensees are seeking to use bankruptcy as a fourth restructuring option, it is included as an "election" for the analysis that follows.

Of the 493 C block licenses, the election results were as follows (figures are approximate, obtained from unaudited information and are before any write-downs or other adjustments that subsequently occurred as a result of the licensee electing either the Amnesty or the Disaggregation options):

Election	Number of Loans/Licenses	% of Total Eligible Licenses	Outstanding Principal Balance As of July 1998	% of Total Outstanding Debt
Amnesty	135	28.8%	\$600,000,000	6.8%
Bankruptcy⁽¹⁾	128	27.3%	\$6,600,000,000	75.0%
Disaggregation	128	27.3%	\$1,200,000,000	13.6%
Resume Payments	77	16.4%	\$400,000,000	4.5%
Prepayment	1	0.2%	\$100,000	0.0%
Total Eligible Licenses	469	100.0%	\$8,800,100,000	100.0%
Other C block licenses ⁽²⁾	24		\$1,600,000	

(1) Licensees who filed for bankruptcy before and after the option election day.

(2) Other C block licenses: 1 licensee representing \$500,000 made no election, 2 licenses representing \$1.1 million were paid in full as of the election date, and 21 licenses were not eligible for restructuring for various reasons.

The Commission defended its C block policy in several *Orders* by stating that more than 90% of the borrowers made timely elections using the offered options, implying that the restructuring methods provided an adequate range of choices and relief while preserving the integrity of the auctions process. However, while 90% of the borrowers may have believed the restructuring options were adequate, the borrowers that represented at least 60% of the outstanding balance may not have.¹ Five C block borrowers have opted for bankruptcy. Of these five, three borrowers (NextWave, GWI, and DCR PCS) represent approximately 99% of the \$6.6 billion outstanding C block principal in bankruptcy.

The Commission reported that during the period in which the Commission was considering restructuring options, two licensees filed for bankruptcy, DCR PCS, Inc., the subsidiary of Pocket Communications, Inc. ("Pocket") and GWI PCS Inc. ("GWI").² In April 1998, the U.S. Bankruptcy Court for the Northern District of Texas issued a bench ruling in the GWI case, allowing the GWI licensees to retain 14 C block licenses for which GWI PCS was the high bidder at the C block auction, but voiding 84% of the debt owed to the Commission for these licenses. The GWI bankruptcy court found that the value of GWI's licenses declined between the date the C block auction ended and the time that the license grants were issued, and held that GWI's undertaking of the obligation to pay the Commission the full bid price for the license was, therefore, a constructive fraudulent conveyance under Section 548 of the Bankruptcy Code. In the court's decision, the court refused to defer to the FCC's role as a regulatory licensing agency, thus treating the Commission as a "creditor" instead of a "regulator" with regard to the C block payments.

As a result of this court decision, several licensees have petitioned the Commission to reconsider its election policy. Most petitions focus on the issues presented by the GWI decision. Several petitioners indicate that they may file for bankruptcy if the Commission fails to postpone C

¹ These percentages do not include DCR PCS, which elected for one of the restructuring options after it had filed for bankruptcy and after the bankruptcy court permitted this election to go into effect.

² DCR PCS filed for bankruptcy before the Commission had issued any ruling, whereas GWI filed for bankruptcy immediately after the principal ruling but before the Commission issued a reconsideration of the decision (which slightly modified the principal ruling).

block elections and payments again. According to the Commission's "*Second Order on Reconsideration of the Second Report and Order*", NextWave, which has already filed for bankruptcy, stated "it would be irresponsible to [our] shareholders not to file for bankruptcy in light of the GWI decision."

As a result of the restructuring of C block, 199 30MHz spectrum licenses with a net bid of \$2.4 billion in the original auction and 133 15MHz spectrum licenses with a net bid of \$700 million in the original auction were returned to the FCC for subsequent auction. These licenses were subsequently auctioned, but did not reach the price levels of the original auction, which were on average almost three times as high as licenses sold in the A and B block auctions, according to FCC management. 347 licenses were placed for subsequent auction and net high bids totaled \$413 million.

Loss Prevention Activities

1. *Does the agency maintain a schedule of receivables?*
2. *Does the agency verify the schedule of receivables to the general ledger? If differences exist, does the agency reconcile the account by researching the receivables?*

Observations:	<p>The FCC does maintain a schedule of receivables. This schedule is reviewed monthly by officials in the Financial Operations Division of the FCC.</p> <p>The Nortridge Loan Tracking System generates a trial balance that is used manually to post installment loans directly to the general ledger. Since the posting of entries is done manually, the possibility of error is increased. As such, posted entries are reviewed monthly by the Branch Chief or designated staff for accuracy.</p>
Sources:	<ul style="list-style-type: none"> • Interview of Financial Operations Division officials

3. *Does the agency prohibit delinquent Federal debtors from obtaining Federal loans or loan insurance guarantees?*

Observations:	<p>The Commission's Form 175, short-form application, for all auctions requires applicants to certify that they are not delinquent on any non-tax debt owed to any Federal agency.</p> <p>The Commission relies only on the borrower's self-certification. It does not conduct a computer match of its borrowers with the delinquent borrowers of other federal agencies. The Commission does not report delinquent installment loan debtors to other Federal agencies.</p>
Sources:	<ul style="list-style-type: none"> • Interview of Wireless Telecommunications Bureau officials

	<ul style="list-style-type: none"> • <i>Fourth Report and Order</i>: FCC 98-176: August 19, 1998
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4. Are credit reporting agency records used to determine credit worthiness?

<i>Observations:</i>	<p>No. Credit worthiness is not a primary consideration of an applicant in the installment loan program. The Telecommunications Act mandates the FCC to promote "economic opportunity and competition and ensure that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women." To accomplish this, the Act granted the Commission authority to "consider alternative payment schedules and methods of calculation, including lump sums or guaranteed installment payments." Thus the Commission must balance its role as a lender with its responsibility to ensure that small businesses, women, and minorities are given the opportunity to participate in the FCC's auction process.</p> <p>Under the loan servicing agreement between FCC and FMS, the FCC authorized FMS to "purchase and evaluate credit reports to identify the best future collection action." This was not performed.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of Wireless Telecommunications Bureau officials • Memorandum of Understanding between U.S. Department of the Treasury Financial Management Service and Federal Communications Commission, June 28, 1996 • The Telecommunications Act of 1996: Section 309 [47 U.S.C. 309]

5. Does the agency participate in a computer match, at least annually, of their delinquent auction installment loan records with the records of Federal employees to identify those employees who are delinquent in repayment of their debts?

<i>Observations:</i>	<p>The FCC does not currently have any Federal employees who are holders of installment loans. Therefore, it does not participate in a computer match of their delinquent installment loan records with the records of Federal employees.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of Wireless Telecommunications Bureau officials

6. Determine the number of days between the date the debt became delinquent and the date the agency referred the debt to FMS.

<i>Observations:</i>	<p>The Commission has approached Treasury about the transferability of its installment loans. According to FCC management, Treasury indicated unofficially that the FCC is not required to transfer its installment debt to</p>
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	<p>Treasury in its current status under the requirements of the DCIA.</p> <p>The FCC rules defining delinquent debt are as follows:</p> <ul style="list-style-type: none"> ⇒ Any licensee that becomes more than 180 days delinquent on an installment payment shall be in default, and the license shall automatically cancel without further action by the Commission (subject to a few exceptions). ⇒ In that event the debt shall be transferred to the Department of Treasury for collection subject to the DCIA. <p>FCC debt that is over 180 days old generally falls into three categories:</p> <ol style="list-style-type: none"> 1. delinquent debt in bankruptcy. 2. delinquent debt not in bankruptcy; borrower should be notified of default; and a new license auctioned to satisfy debt. 3. debt established from the "Interactive Video and Data Services" auction is under a regulatory proceeding (under DCIA rules, delinquent debts in the administrative appeals process do not have to be transferred to Treasury until after the appeal process is completed and the amount due has been fixed.) <p>According to the DCIA, a creditor agency is not required to transfer a debt to FMS if the debt is in litigation or foreclosure. Litigation is defined as (1) a debt referred to the Attorney General for litigation by the creditor agency; or (2) a debt that is the subject of proceedings pending in a court of competent jurisdiction, including bankruptcy proceedings, whether initiated by the creditor agency, the debtor, or any other party.</p> <p>A debt is considered in foreclosure if:</p> <ul style="list-style-type: none"> • collateral securing the debt is the subject of judicial foreclosure proceedings in a court of competent jurisdiction; or • notice has been issued that collateral securing the debt will be foreclosed upon, liquidated, or otherwise transferred pursuant to applicable law in a non-judicial proceeding; and • the creditor agency anticipates that proceeds will be available from the liquidation of the collateral for application to the debt. <p>Because the FCC anticipates that proceeds will be available from the auction of new licenses for application to the installment debt, the FCC does not believe it is required to transfer any loan until it auctions the new license. The receivable transferred to Treasury at such time would then be the equivalent of a deficiency balance (the amount of the installment loan minus the proceeds from the auction of the license, if greater than \$0.)</p> <p>The FCC has referred installment loans tied up in bankruptcy to the</p>
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	Department of Justice for litigation.
	<ul style="list-style-type: none"> • Interview with Wireless Telecommunications Bureau officials and Financial Operations Bureau officials • Debt Collection Improvement Act of 1996

7. Determine the ratio of delinquent debt to total receivables.

Assessment of Delinquent Debt

According to the DCIA, a debt is defined as “delinquent” if it has not been paid by the payment date or by the end of any grace period contractually provided. The current FCC auction installment loan program rules defining installment payments that are past due are as follows:

- Licensees that do not make an installment payment on or before a due date are automatically granted a 90-day grace period (“non-delinquency period”) and assessed a late fee equal to 5 percent of the missed installment payment.
- If remittance of the missed installment payment and the 5 percent late fee is not made on or before expiration of the non-delinquency period, a second 90-day grace period (“grace period”) is automatically granted and an additional late fee equal to 10 percent of the missed installment payment is assessed.
- Licensees are not required to make an application to the Commission to receive the non-delinquency period or the grace period.
- Any licensee that becomes more than 180 days past due on an installment payment shall be in default, and the license shall automatically cancel without further action by the Commission.

There are a few exceptions to the above rules that would cause a loan more than 180 days past due not to be in default (example: pending waiver request, error in recognizing payment). However, since FCC spectrum auction rules provide for two automatic 90-day grace periods, an installment loan would *generally* be considered “delinquent” subject to the DCIA on the 181st day after the payment due date, provided that no waiver has been requested or granted by the FCC.

The amount of delinquent debt shown below includes the entire outstanding principal balance for those loans which are delinquent, not just the past due portion of the debt. Based on unaudited various sources indicated, the amount of delinquent FCC installment debt is summarized below:

Auction Blocks	Amount of Outstanding Principal Greater Than 180-Days Past Due	Percentage of Total Outstanding Principal Balance (#'s 5, 6, 7, 10, 11)
#5, #6, #7, #10, #11	\$6,828,000,000	92%

Note: The above figure is from unaudited data derived from the sources indicated below. The above figure may include:

- licensees over 180-days past due with pending waiver requests that may alter the delinquency status of the loan
- licensees who appear over 180-days past due because a payment was applied incorrectly in the Nortridge Loan Tracking System or was held in suspense.

Source: Auction payment schedule provided by Financial Operations Division as of April 27, 1999; Schedule of bankrupt borrowers prepared for SF220-9

See Appendix 1 for additional information

Auction Blocks	Amount of Outstanding Principal Greater Than 180-Days Past Due	Percentage of Total Outstanding Principal Balance (#'s 2, 3, 4)
#2, #3, #4	\$158,000,000	22%

Note: The above figure is from unaudited data. The above figure may include:

- licensees over 180-days past due with pending waiver requests that may alter the delinquency status of the loan.
- licensees who appear over 180-days past due because a payment was applied incorrectly in the Nortridge Loan Tracking System or held in suspense.

Source: Trial Balance from Nortridge Loan Tracking System as of 3/31/1999.

See Appendix 1 for additional information

Since installment payment rules provide for two automatic grace periods totaling 180 days, FCC installment debt is considered "delinquent" per DCIA guidance on the 181st day after payment is due. The Nortridge Loan Tracking System is used by the FCC and Treasury FMS in Birmingham, AL (FCC's contracted loan servicer) to maintain its installment loan portfolio. The FCC prepares past due reports for its auction blocks #5 ("C block" – Broadband PCS Auction), #6 ("MDS" – Multipoint/Multichannel Distribution Services Auction), #7 ("SMR" – Specialized Mobile Radio Service Auction), #10 ("C block" – Broadband PCS Auction), and #11 ("F block" – Broadband PCS Auction). The other auction blocks, #2 ("IVDS" – Interactive Video and Data Services), #3 (Narrowband PCS), and #4 (Broadband PCS)³ are not considered by the FCC to be covered under the Credit Reform Act of 1990 ("Credit Reform Act") according to FCC

³ The FCC awarded APC, Cox and Omnipoint broadband PCS A/B block licenses under the pioneer's preference program. Other licenses in these blocks were sold in Auction 4. These three licenses were not awarded through auction. However, after the licenses were awarded the Commission required the pioneer preference licensees to pay 85% of the adjusted value of the licenses. The pioneer's preference licensees were permitted to make this payment in installment payments.

management. We understand that based on an informal agreement between OMB and the FCC, the FCC did not have to report installment payment plans for Auction Blocks #2, #3, and #4 as loans under the Credit Reform Act. In auction blocks #1, #8, and #9, the installment payment program was not offered.

II. DOCUMENTING AND CLASSIFYING DELINQUENT DEBT

Review Objectives:

- A. Documentation - To determine whether the agencies are documenting and reporting non-tax delinquent debt.
- B. Classification - To assess if the non-tax delinquent debt is properly classified.

Documentation

1. *Determine whether adequate documentation from the agency is provided to ensure that delinquent installment debt sent to FMS is collectible.*

<i>Observations:</i>	<p>The FCC has not referred any of its delinquent Spectrum Auction installment loans to FMS for collection because it does not fit the criteria to be transferred. The delinquent debt is either tied up in bankruptcy or the Commission expects to apply proceeds from the auction of new licenses to the debt (See Page 14 above). However, the FCC has maintained a loan servicing agreement with FMS since 1996.</p> <p>FCC has compiled loan files with the information necessary to certify a debt as delinquent and collectible. While no installment debt has been transferred to FMS for collection, the documentation, for most auctions, does exist should the Commission decide to do so.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview with Wireless Telecommunications Bureau and Financial Operations Division officials.

2. *Review the certifying procedures used by the agency to verify that the installment debt is delinquent. Determine:*
 - a. *What steps does the agency take to ensure that the debt is collectible?*
 - b. *Is the documentation reviewed for each debt before it is certified?*
 - c. *If there is no documentation to verify that the debt is owed by the debtor, what other means does the agency use to verify that it is delinquent debts?*
 - d. *Are program agencies certifying correct and legally enforceable information when referring debt to the Treasury Offset Program or for cross-servicing?*
 - e. *Are program agencies discontinuing collection actions once the debt has been referred for cross-servicing?*

<i>Observations:</i>	<p>The DCIA requires that the head of an agency or someone with authority to act on behalf of the head of the agency with regard to debt collection matters, must certify to FMS or to a debt collection center that debts transferred are valid and legally enforceable, that there are no legal bars to collection, and that all due process requirements have been met. This means that the agency must certify that it has made a final determination that the debt is due in the amount transferred, that there are no legal bars to collection such as bankruptcy, and that the agency has provided (or has arranged to provide) the debtor with notice and an opportunity to be heard where required as a prerequisite to a particular collection action.</p> <p>The FCC has not referred any of its Spectrum Auction installment debt to Treasury for collection. It has not certified any installment debt for referral to Treasury. The Commission, however, is not required to transfer its installment debt under the requirements of the DCIA because the delinquent debt is either tied up in bankruptcy or the Commission expects to apply proceeds from the auction of new licenses to the debt (See Page 14 above).</p> <p>The FCC is designing procedures for certification to ensure that delinquent installment loans referred to FMS are collectible per DCIA requirements.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Debt Collection Improvement Act of 1996 • Interview of Wireless Telecommunications Bureau, Financial Operations Division, and Office of the General Counsel officials

3. *Are agencies providing additional information to FMS and/or the debtor when requested?*

<i>Observations:</i>	<p>The FCC and FMS (under their loan servicing agreement) provide information to debtors when requested. They receive the majority of the information requests shortly after billing statements are mailed. The requests range from inquiries about the amount owed on the statements to requests for an updated amortization schedule.</p> <p>Licenses also often contact the FCC with concerns that they cannot calculate the amount they owe with any degree of precision. FMS will usually refer these types of issues to the Billings and Collections Branch at FCC headquarters in Washington, DC.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of FCC contractors • Memorandum of Understanding between U.S. Department of the Treasury Financial Management Service and Federal Communications Commission, June 28, 1996.

4. Are the agencies providing the Taxpayer Identification Number to FMS.

Observations:	As part of the loan servicing agreement the FCC has with FMS, FCC has sent FMS the taxpayer identification number. However, the FCC has not transferred any of the spectrum auction installment loans to FMS for collection. The FCC maintains it is not required to transfer its installment loans under the requirements of the DCIA because the delinquent debt is either tied up in bankruptcy or the Commission expects to apply proceeds from the auction of new licenses to the debt (See Page 14 above).
Sources:	<ul style="list-style-type: none">• Interview of Wireless Telecommunications Bureau officials• Memorandum of Understanding between U.S. Department of the Treasury Financial Management Service and Federal Communications Commission, June 28, 1996.

Classification

1. *Obtain and review the Federal and Department regulations, policies, directives and manuals on delinquent debt such as the Debt Collection Improvement Act of 1996.*
2. *Determine whether the delinquent debt is properly classified as delinquent and not classified incorrectly.*

Observations:	The FCC has never been required to prepare audited financial statements. As a result, there is no formal classification of debt as delinquent and non-delinquent for reporting purposes. The FCC classifies debt on its SF220-9 report as current and non-current. This report is currently being reviewed for its accuracy as part of this contract.
Sources:	<ul style="list-style-type: none">• Interview of Financial Operations Division officials

3. *If the delinquent debt is returned by FMS as uncollectible, document the procedures used to classify the returned debt. Document the classification given the returned debt. Is it reclassified as current, delinquent or written off?*

Observations:	None of the spectrum auction installment loans have been transferred to FMS. The FCC maintains it is not required to refer its installment debt under the requirements of the DCIA because the delinquent debt is either tied up in bankruptcy or the Commission expects to apply proceeds from the auction of new licenses to the debt (See Page 14 above). There are currently no procedures specific to installment loans to classify returned installment loans from FMS.
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<i>Sources:</i>	• Interview of Financial Operations Division officials
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4. *Are delinquent installment loans which have been determined to be uncollectible being properly written off?*

<i>Observations:</i>	At this time, the FCC has not made an overall financial assessment of its installment loan portfolio. Accordingly, the FCC has not written off any loans considered uncollectible at this time.
<i>Sources:</i>	• Interview of Financial Operations Division officials

5. *Document the procedures used to determine if the debt is uncollectible and should be written off.*

<i>Observations:</i>	The FCC does not have formal written procedures specific to installment loans to determine if the loan is uncollectible and should be written off.
<i>Sources:</i>	• Interview of Financial Operations Division officials

6. *Are agencies recalling debts after they have been submitted?*

<i>Observations:</i>	The FCC has not submitted any installment loans to FMS for collection. The FCC maintains it is not required to refer its installment loans under the requirements of the DCIA because a large percentage of the portfolio is tied up in bankruptcy and the Commission expects to apply proceeds from the auction of new licenses to the debt (See Page 14 above).
<i>Sources:</i>	• Interview of Financial Operations Division officials

III. ACCOUNTS RECEIVABLE

Review Objectives

- A. Existence of accounts receivable – To determine that the receivables exist, are authentic obligations owed to the Federal government, and contain no significant amounts that should be written off.
- B. Collectibility – To assess the degree of collectibility of the outstanding debt.
- C. Revenue recognition – To determine whether interest on accounts receivable has been properly assessed and recorded.

Existence of Accounts Receivable

Due to the volume of accounts receivable, some OIG offices may need to use statistical sampling and project the results to the universe of debt.

1. Identify programs which resulted in the accounts receivable.

<i>Observations:</i>	This document focuses on the receivables resulting from the Spectrum Auction's installment payment program that comprises the major portion of the FCC's debt.
<i>Sources:</i>	<ul style="list-style-type: none">FCC Management

2. Obtain a listing of the debt which comprises the accounts receivable for each program identified.

<i>Observations:</i>	See Appendix 3.
<i>Sources:</i>	<ul style="list-style-type: none">Nortridge Loan Tracking System

3. Prepare a lead schedule detailing 9/30/97 accounts receivable balances (or other recent date).

<i>Observations:</i>	See Appendix 4.
<i>Sources:</i>	<ul style="list-style-type: none">Nortridge Loan Tracking System

4. Categorize the "type" of debt, e.g., student loan, venture capital loan, etc.

<i>Observations:</i>	As requested by the Inspector General of the Federal Communications Commission, this document focuses <u>only</u> on the FCC's Spectrum Auction installment payment program.
<i>Sources:</i>	<ul style="list-style-type: none">Office of Inspector General

5. Trace FY 97 year-end balances (or other date) to current year's general ledger.

<i>Observations:</i>	Principal and interest balances reported on the general ledger as of September 30, 1998 were traced to subsidiary records from the Nortridge System and to the <i>Report on Receivables Due from the Public</i> (SF 220-9). As of the quarter ended September 30, 1998, fees and late charges of \$66,460,813 were not reported on the SF 220-9. See Appendices 4 and 5.
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<i>Sources:</i>	<ul style="list-style-type: none"> • Nortridge Loan Tracking System (unaudited) • Report on Receivables Due from the Public (SF 220-9) (unaudited)
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6. Record any post-closing and auditor adjustments to the lead schedule.

<i>Observations:</i>	<p>The FCC has not been required to prepare financial statements. As such, there were no post closing and audit adjustments as of September 30, 1998. However, on the SF 220-9 for the quarter ended December 31, 1998, there were manual adjustments of \$2,280,423 (principal) and \$17,855 (interest). The adjustments are due to collections that had not been posted to Nortridge.</p> <p><i>See Appendices 4 and 5</i></p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Nortridge Loan Tracking System (unaudited)

7. Have appropriate agency personnel explain unusual and/or significant fluctuations between FY 1997 closing balances and FY 1998 beginning balances (or other date).

<i>Observations:</i>	<p>The accounts receivable balance increased by less than 0.1% between the last quarter of FY 1998 and first quarter FY 1999. This increase is immaterial. No unusual fluctuations were noted.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of Financial Operations Division officials

8. Obtain the following origination information for the outstanding debt from source documents:

- a. Maker:
- b. Date made/date due:
- c. Original terms of repayment:
- d. Collateral, if any:
- e. Interest rate:
- f. Balances as of the last payment:
- g. Date of last payment:

This information was obtained from the Nortridge Loan Tracking System as of March 31, 1999.

Collectibility

1. ***Did the debt origination information documented in step 8 above come from original loan document? If yes, go to step 2. If no, obtain the original loan documents and verify the information collected in step 8 above.***

No independent assessment was made to determine the reliability of the Nortridge installment loan information or the availability of original loan documentation in connection with the preparation of this Review Guide. However, loan file documentation was obtained and reviewed in connection with the FCC's Loan Auditability project being conducted by the FCC's Financial Operations Division and Wireless Telecommunications Bureau. For installment loans related to auction blocks #5, 6, 7, 10 and 11, the information listed above, with the exception of balances as of the last payment date and the date of last payment, is purported to be generally available from source documentation to support accounts receivables. In a few loan files, key documentation such as the loan note, UCC filing, and/or security agreement is not included. As a result, these loan files may not contain the information listed above. For auction blocks #2, 3, and 4, loan notes and security agreements do not exist. In these cases, the information listed above can be obtained from the Nortridge Loan Tracking System and auction closing public notices.

2. ***Ascertain whether debts are involved in proceedings that would limit their collectibility. Such processes would include:***

- a. Foreclosure
- b. Bankruptcy
- c. Forbearance
- d. Death of Debtor

Observations:	<p><i>Forbearance</i></p> <p>The installment loans from the IVDS auctions are currently in forbearance as the Commission is discussing redefining the spectrum allocated to the IVDS service in order to provide greater use to the marketplace. The IVDS loans represent about \$86 million in outstanding debt.</p> <p><i>Bankruptcy</i></p> <p>According to FCC management, the following companies in the FCC installment loan program have filed for bankruptcy (figures are from unaudited information; dollar amounts are approximations):</p> <ul style="list-style-type: none">• NextWave, outstanding principal balance of \$4.4 billion• DCR PCS Inc., outstanding principal balance of \$1.3 billion• GWI, outstanding principal balance of \$954 million• UrbanComm, outstanding principal balance of \$77 million• CONXUS Communications, outstanding principal balance of \$73 million
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	<ul style="list-style-type: none"> • MagnaComm, outstanding principal balance of \$48 million • Interactive Acquisition Partners, outstanding principal balance of \$5 million • Communication Ventures, outstanding principal balance of \$4 million • American National Communications, Inc., outstanding principal balance of \$3 million <p>The total amount of debt tied up in bankruptcy, approximately \$6.8 billion, represents about 77% of the entire amount of outstanding installment loan debt.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of Office of the General Counsel officials • <i>Second Order on Reconsideration of the Second Report and Order</i>; FCC 99-66; Released April 5, 1999

3. *Has the original debt been restructured? If yes, what are the new payment arrangements?*

<i>Observations:</i>	See Section I (Collection Activities), Question 1(b.)
<i>Sources:</i>	See Section I (Collection Activities), Question 1(b.)

4. *Prepare an aging schedule to analyze the length of time the debt has been outstanding. For example, 1-6 mo., 7-12 mo., 13-18 mo., 18-24 mo., over 24 mo.*

<i>Observations:</i>	See Appendix 2 for Past Due Report from Nortridge.			
	Past Due Category	# of Loans/ Licenses	Principal Balance	% of Total
	Current	540	1,132,950,687	12.90%
	1-30 Days Past Due	9	536,016	0.01%
	31-60 Days Past Due	94	15,595,883	0.18%
	61-90 Days Past Due	126	323,752,503	3.69%
	91-120 Days Past Due	21	779,856	0.01%
	121 + Days Past Due	991	7,309,690,443	83.22%
	Total	1,781	8,783,305,387	100.00%
<i>Sources:</i>	<ul style="list-style-type: none"> • Unaudited Standard Past Due Report from the Nortridge Loan Tracking System generated as of 4/14/1999 			

5. Categorize receivables per the aging schedule in step 4.

Observations:	For categorization of receivables, see Amount of Delinquent Debt on Page 16 above.
Sources:	<ul style="list-style-type: none"> • Unaudited reports and spreadsheets provided by Financial Operations Division officials and Nortridge Loan Tracking System

6. Evaluate the results of steps 1-5 and assess the collectibility of the outstanding debt.

Observations:	<p>According to FCC management, the FCC has not made an overall financial assessment of the collectibility of its installment loan portfolio. For OMB credit subsidy estimate and re-estimate purposes, the Commission obligated budget authority equal to \$5.4 billion, or approximately 60% of the face amount of its C and F block installment loans. This obligation represents the Administration's current estimate of the present value of the costs (or losses) on these loans as of the date of origination. It includes the net impact of late or missed payments, financing costs, prepayments, defaults, and recoveries.</p> <p>The FCC is in the process of preparing financial statements for the fiscal year ended September 30, 1999 in connection with an upcoming audit. The FCC has tentatively concluded that it will use the hierarchy of accounting principles and standards for Federal agencies as outlined in OMB Bulletin 97-01, "<i>Form and Content of Agency Financial Statements</i>".</p> <p>The accounting principles and reporting objectives established for the Federal government include the following requirements regarding the assessment of loan receivables:</p> <ul style="list-style-type: none"> • Federal Accounting Standards and Advisory Board ("FASAB") Statement of Federal Financial Accounting Standards (SFFAS) No. 2 <ul style="list-style-type: none"> ⇒ Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance. ⇒ A subsidy expense is recognized for loans disbursed during a fiscal year. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows. ⇒ The subsidy cost allowance for direct loans are reestimated
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	<p>each year, taking into account all factors that may have affected the estimated cash flows. Any adjustment resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense.)</p> <p>⇒ When direct loans are modified, the cost of modification is recognized at an amount equal to the decrease in the present value of the direct loans or the increase in the present value of the loan guarantee liabilities measured at the time of modification.</p> <p>⇒ Upon foreclosure of direct loans, the acquired property is recognized as an asset at the present value of its estimated future net cash inflows.</p> <p>⇒ Direct loans obligated and loan guarantees committed after September 30, 1991, must be accounted for on a present value basis, which is consistent with the intent of the Federal Credit Reform Act of 1990.</p> <p>Based on SFFAS No. 2 and other standards published by OMB, the FCC is supposed to prepare an accounting of its installment loan portfolio based on the present value of the eventual expected cash inflows resulting from the installment loans. This accounting may require the Commission to place a value on its licenses. The FCC management indicated it does not currently perform valuations of spectrum licenses because this is the job of the marketplace, and pronouncements in advance of an auction may skew the auction results. Moreover, FCC management has expressed concerns that a valuation done outside the context of litigation may affect the pending bankruptcy cases.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of Financial Operations Division officials • Federal Accounting Standard and Advisory Board SFFAS No. 2 • Federal Credit Reform Act of 1990

7. Determine whether the debt is secured with collateral.

<i>Observations:</i>	All of the installment loans are secured by the spectrum license purchased in the auction and financed by the installment loan program.
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of Wireless Telecommunications Bureau officials

a. Is the collateral encumbered?

<i>Observations:</i>	The FCC is the first lien holder on all its licenses securing an installment loan.
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview of Wireless Telecommunications Bureau officials

b. Determine the market value. Is the market value adequate to satisfy the debt if seized?

Observations:	<p>The FCC management has stated it does not currently value its spectrum licenses. They stated this is the job of the market and the auction process.</p> <p>However, estimates have been made regarding the value of the loans and the license by third parties. In the bankruptcy case regarding GWI, the court ruled that the value of certain licenses in the C block as of January 1997 was worth only 16 cents on the dollar.</p> <p>For OMB credit subsidy estimate and re-estimate purposes, the Commission obligated budget authority equal to \$5.4 billion, or approximately 60% of the face amount of its C and F block installment loans. This obligation represents the Administration's current estimate of the present value of the costs (or losses) on these loans as of the date of origination. It includes the net impact of late or missed payments, financing costs, prepayments, defaults, and recoveries.</p> <p>In the original auction of the C block licenses, the bidders appear to have paid a premium for the licenses. According to published articles, NextWave bid \$994 million for licenses covering the New York City metropolitan market. This translates into a bid of \$55 per person in the market, more than three times what Sprint PCS paid per person for a license covering the New York area. Combined, the winning C block bidders paid an average of \$40 for each potential customer, close to triple the A block and B block spectrum prices.</p> <p>C block licensees believed they could support the premium by focusing on the generous financing terms the government was offering. This does not appear to be the case since approximately 77% of the portfolio is in bankruptcy. Weighing these and other factors, the Commission decided to suspend the installment loan program (i.e., it decided to stop offering an installment payment option when auctioning new licenses). Thus, the market value of the licenses may not be sufficient to satisfy the outstanding debt.</p>
Sources:	<ul style="list-style-type: none">• Interview of Wireless Telecommunications Bureau officials and Office of the General Counsel officials• "Hollow Victory", by Peter Spiegel, <i>Forbes</i>, January 27, 1997

c. Can the collateral be seized to satisfy loan?

Observations:	<p>This is a pending issue. It is the Commission's view that FCC licenses are granted subject to conditions, such as full payment of net winning bids and, should those conditions not be met, the licenses cancel. The Commission is currently seeking assistance from Congress to clarify that FCC licensees</p>
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	<p>who default on their installment payments may not use bankruptcy litigation to avoid such automatic cancellation.</p> <p>However, in the absence of clarifying legislation, there is a risk that valuable spectrum licenses will be tied up in litigation, delaying the cancellation of the existing licenses and the subsequent auction of the new licenses, the introduction of new services and competition, and the collection of revenues.</p> <p>For example, a number of FCC licensees have argued that, even if they default on their installment payments the licenses do not automatically cancel and the Commission cannot auction new licenses while bankruptcy litigation is pending. Thus far, court decisions have favored the licensees.</p> <p>The Commission believes this is an incorrect reading of the statutory scheme. Specifically, the Commission believes that FCC licenses are not "property" subject to the bankruptcy code, and that even under bankruptcy law, a debtor cannot retain the license without satisfying its full obligation. The Commission does not believe that Congress intended to allow licensees to use Chapter 11 or Chapter 7 bankruptcy litigation as a means to hoard valuable FCC licenses.</p>
<i>Sources:</i>	<ul style="list-style-type: none"> • Interview with Office of the General Counsel officials • <i>Report to Congress</i>, FCC 97-353, October 9, 1997

8. Rank the probability of collection using the following scale:

VERY COLLECTIBLE					MINIMALLY COLLECTIBLE				
1	2	3	4	5	6	7	8	9	10

The FCC has not made an overall financial assessment of the collectibility of its installment loan portfolio. The above ranking cannot be performed at this time.

Revenue Recognition

1. Determine whether interest has been assessed on the outstanding receivable balances.

<i>Observations:</i>	Interest has been assessed on the outstanding receivable balances.
<i>Sources:</i>	<ul style="list-style-type: none"> • Trial Balance from Nortridge Loan Tracking System

2. *If interest has not been assessed, determine the interest amount that should have been assessed. This represents additional moneys owed to the Federal government.*

<i>Observations:</i>	Interest has been assessed on the outstanding receivable balances.
<i>Sources:</i>	<ul style="list-style-type: none">• Trial Balance from Nortridge Loan Tracking System

APPENDIX 1
Notes Regarding Estimation of Delinquent Debt

Determination of Delinquent Debt: Auction Group #'s 5, 6, 7, 10, 11

The amount of delinquent debt was determined from a past due schedule as of April 27, 1999, provided by FCC management for auction group #'s 5, 6, 7, 10, and 11. The schedule did not include four licensees in bankruptcy: NextWave, GWI, DCR PCS Inc., and American National. The outstanding principal balance for the loans of these companies was determined from a separate schedule prepared for these four borrowers. The outstanding principal balance for these borrowers is as follows:

NextWave:	\$4,368,000,000
GWI:	\$ 954,000,000
DCR PCS:	\$1,284,000,000
American National:	\$ 3,000,000

Determination of Delinquent Debt: Auction Group #'s 2, 3, 4

Because a detailed past due schedule was not available for auction blocks #2, #3, and #4, the amount of delinquent debt was determined from the Trial Balance from the Nortridge Loan Tracking System as of March 31, 1999. The trial balance does not report the number of days past due, but does report the last payment date. From the last payment date, the number of days since the last payment was received can be determined as of March 31, 1999. In these loan groups, most loans are either clearly current (less than 100 days since the last payment was received) or clearly delinquent (more than 365 days since the last payment was received.) A loan is assumed to be delinquent if a payment has not been received in 273 days (scheduled payment date + 92 days until next scheduled payment + 181 days past due = delinquent). This assumes that the last payment was a full payment received on the scheduled payment due date.

Of the 452 licenses with loans outstanding in auction group #'s 2, 3, and 4 as of March 31, 1999:

- 37 licenses (\$428,819,405 outstanding principal balance) had made a payment in the last 91 days – **current**
- 1 license (\$270,687,030 outstanding principal balance) had not made a payment in 149 days – it is assumed that this payment was made on the scheduled payment due date, therefore it is classified as **current**
- 2 licenses (\$101,902 outstanding principal balance) had not made a payment in 161 days – it is assumed that this payment was made on the scheduled payment due date, therefore it is classified as **current**
- 1 license (\$250,848 outstanding principal balance) had not made a payment in 273 days – it is assumed that this payment was made on the scheduled payment due date, therefore it is classified as **delinquent**
- 411 licenses (\$157,779,626 outstanding principal balance) had not made a payment in the last 362 days or more – **delinquent**

Past Due Report

APPENDIX 2

Complete Listing - Past Due Range between 0 and 9999 days of Loan Class ALL Ordered by CIFNO Grouped by Loan Group

Page 1

	Original Past Due	Amount Paid	Past Due Balance
Grand Total - - -	0.00	0.00	0.00

Loans Listed:	0	Percent of Past Due Loans:	0.00
Loans Past Due:	1241	Percent of Past Due Payments:	0.00
Total Loans:	1781	Percent of Past Due Principal:	0.00

Past Due Recap					
Past Due Category	Number Of Loans	Principal&Interest Past Due	Principal Balance	Percent Of Loans	Percent Of Payments
Current	540	0.00	1,132,950,686.75	30.32	0.00
1 - 30 Days Past Due	9	20,719.29	536,015.76	0.51	0.00
31 - 60 Days Past Due	94	216,986.27	15,595,883.10	5.28	0.02
61 - 90 Days Past Due	126	5,075,017.24	323,752,502.63	7.07	0.48
91 - 120 Days Past Due	21	146,283.12	779,855.89	1.18	0.01
121 + Days Past Due	991	1,048,507,520.94	7,308,690,442.98	55.64	99.48
Totals	1781	1,053,986,528.86	8,783,305,387.11	100.00	100.00

Appendix 3
Summary of Trial Balance
Nortridge Loan Tracking System
As of March 31, 1999
Unaudited

Auction Group	Auction Block	Principal	Interest	Fees & Late Charges	Total Balance
2	IVDS	86,461,924	21,159,811	0	107,621,736
3	Narrowband PCS	119,091,422	13,913,821	385,258	133,390,501
4	Pioneer	518,772,103	11,921,049	999,999	531,693,152
5&10	Broadband PCS: C Block	7,453,585,344	987,497,875	51,547,337	8,492,630,556
6	MDS	93,310,344	5,918,423	269,281	99,498,047
7	SMR	41,863,015	2,969,002	85,840	44,917,857
11	Broadband PCS: F Block	498,551,358	19,333,772	15,071,015	532,956,145
Total		8,811,635,510	1,062,713,753	68,358,730	9,942,707,994

Notes

- 1) The information above was obtained from the unaudited Trial Balance from Nortridge.
- 2) Above includes all Auction Groups, including numbers 2,3 and 4 which are not currently being reported by the FCC on the Form SF 220-9 "Schedule of Receivables due from the Public"

Appendix 4
Federal Communications Commission
Reconciliation of Schedule of Receivables Due From Public To Nortridge System
As of September 30, 1998
Unaudited

Loan Group	Principal	Interest	Fees & Late Charges (2)	Total Balance
5	6,946,239,765	709,867,907	(45,493,754)	\$7,701,601,426
6	96,337,607	4,770,778	(92,893)	\$101,201,278
7	43,137,591	2,233,782	(25,602)	\$45,396,975
10	507,351,478	55,541,345	(1,406,455)	\$564,299,278
11	497,284,043	15,793,385	(19,442,110)	\$532,519,538
Adj. (3)	(2,280,423)	(17,855)	0	(\$2,298,278)
Total	\$8,088,070,061	\$788,189,342	(\$66,460,814)	\$8,942,720,217

Notes

- 1) This information was obtained from the unaudited Nortridge Loan Tracking System
- 2) Fees and late charges were not reported on the Report of Receivables Due from the Public.
- 3) Manual adjustment to Nortridge balances due to collections that had not been posted to Nortridge.
- 4) Above does not include amounts for Auction Groups Numbers 2,3, and 4 because the FCC does not report these as Receivables Due from the Public on Form SF 220-9.

Appendix 5
Federal Communications Commission
Report of Receivables Due from the Public
Unaudited

Fourth Quarter Ended September 30, 1998

	<u>Principal</u>	<u>Interest & Late Charges</u>
Beginning Balance	7,595,196,160	426,607,370
New Receivables	1,858,581,748	
Accruals		361,581,972
Collections		
Adjustments		
a. Reclass/Adjust.		
b. Est. Value Acq. Prop.		
c. Est. Loss Coll Debt		
Amount Written Off (1)	(1,365,707,848)	
Ending Balance	8,088,070,060	788,189,342
a. Current Receivables (2)	2,320,694,693	788,189,342
b. Noncurrent Receivables	5,767,375,367	0
Allowance Account	(5,260,016,407)	(788,189,342)
Total Receivable Net of Allowance	2,828,053,653	0

Notes

- 1) Information was obtained from unaudited Form SF 220-9 as of September 30, 1998 prepared by the FCC
- 2) Amount represents adjustment attributed to restructuring of C-Block license
- 3) Large balance reported for current receivables is due to FCC policy of reporting total balance outstanding from delinquent borrowers as current.

UNITED STATES GOVERNMENT
FEDERAL COMMUNICATIONS COMMISSION
MEMORANDUM

RECEIVED

NOV 12 12 50 PM '99

OFFICE OF THE
INSPECTOR GENERAL

DATE: November 8, 1999

To: Walker Feaster
Inspector General

FROM: Andrew Fishel
Managing Director

*Walker Feaster
for Andy Fishel*

SUBJECT: Response to Draft Reports Related to Non-Tax Delinquent Debt

Thank you for the opportunity to review (1) the Observations and Recommendations on FCC's Report on Receivables Due from the Public and (2) the Debt Management Observations and Recommendations recently issued by the Office of the Inspector General. Overall the observations and recommendations found in these reports support the efforts initiated by OMD, WTB and the OIG over the last year to increase the effective management of the Auction Loan Portfolio and improve both internal and external reporting on this Portfolio. The reports raise two open policy issues which have been under considerable discussion: (1) the applicability of the credit qualification requirements specified in the DCIA to auction loans and (2) the accounting issues associated with determining the value of defaulted debt. In this later regard, The Office of General Counsel is guided by advice set forth in the *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* (ABA, December 1975). That Statement said, "In view of the inherent uncertainties, the lawyer should normally refrain from expressing judgements as to outcome except in those relatively few clear cases where it appears to the lawyer that an unfavorable outcome is either 'probable' or 'remote'." This guidance makes it very difficult, if not impossible, to estimate the outcome of current cases where a debtor has defaulted on an auction loan obligation.

The Office of General Counsel also offered numerous specific changes to wording in the *Overview of Delinquent Debt and Debt Management Activities*, *Overview of Approaches for Determining Collectibility of Spectrum Auction Loan Portfolio*, and the *Performance Review Guide Results to Date* reports. These changes are noted in attachment B to this memorandum. The responses to the audit report offered here incorporate and have been approved by the Wireless Telecommunications Bureau (WTB) and the Office of General Counsel (OGC).

ATTACHMENT A

"Responses to "Observations and Recommendations on FCC's Report on Receivables Due from the Public"

1. Accruals

Recommendation: The FCC is currently not reporting any accruals on the SF 220-9. The FCC should include the amount of assessed late fees and earned interest on the SF 220-9 in the future.

Response: We concur with this change in the interpretation of the Treasury reporting requirements and agree it will provide more accurate information concerning the amounts owed the FCC. The limitations of the current loan tracking system make the reporting of this information difficult. Changes will be implemented so that future reports will reflect earned interest and late charges in Section A. Line 3 of the SF 220-9.

2. Adjustments

Recommendation A: Adjustments (as noted on Form SF220-9) track the number and dollar amount of changes to receivables during the fiscal year due to reclassification or adjustments, acquisition of property, estimated losses on acquired property, or consolidations.

The FCC will need to track adjustments, which result from its current loan balance recalculation efforts. The FCC, with contractor assistance, is in the process of sending confirmation letters to borrowers to confirm loan balances and terms. Loan Balances have been recalculated separately from the Nortridge Loan Tracking System. Accordingly, the resulting loan balance from the confirmation process may vary from what is currently reported in Nortridge and on the Schedule of Receivables. As the confirmation process is completed, the differences between the balances previously reported on the SF 220-9 and the confirmed, recalculated balances should be reflected here.

Response A: Concur. As the loan balances are recalculated and confirmed with the borrowers, amendments to the amounts previously reported on the SF 220-9 will be reported as Adjustments on future SF 220-9.

Recommendation B: Confirmation letters have not been sent to borrowers in default or in bankruptcy. Adjustments (SF 220-9) should be reported on these loan balances as litigation is completed or as the auction of a new license to use spectrum associated with a cancelled license is completed. FASAB 2 requires that when property is transferred from borrowers to a Federal credit program, through foreclosure or other means, in partial or full settlement of post-1991 direct loans the property is recognized as an asset at the present value of its estimated future net cash inflows discounted at the original discount rate. Accordingly, the FCC should establish accounting policy to handle the valuation of defaulted debt and the estimated loss should be reported as an adjustment of the SF 220-9.

Response: We concur that a financial operations policy must be written that addresses the valuation of a new licenses to use spectrum associated with a cancelled license and that the estimated loss should be reported as an adjustment of the SF 220-9.

OGC and WTB maintain that attempts at assigning value through any means other than the subsequent auction of the spectrum related to the defaulted license, have the potential to (a) affect the government's exposure in litigation because of the inherent inaccuracies of other methods of valuation, and (b) to skew the bidding dynamics of upcoming auctions and thereby undermine the integrity of the auctions process. OMD will therefore adopt a methodology that defers valuation at the value of a cancelled license until the auction of a new license to use the spectrum associated with the cancelled license. If necessary we will approach the FASAB concerning clarification of this position. The importance of this issue is evidenced by the legislation currently before Congress to resolve the confusion associated with the ownership of the license and the relationship between the license and the loan.

3. Delinquent Debt by Age

Recommendation: On the aging schedule submitted on the SF 220-9 there should be no loans reported as being 1 - 180 days delinquent. Additionally, for all loans that are delinquent, the amount of delinquent debt reported on the SF 220-9 should be the entire outstanding principal balance. This is consistent with Treasury guidance that states that "the entire amount of debt is recorded as delinquent if any part of it has been delinquent more than 180 days"

Response:

Concur. According to auction installment loan program rules, payments are not delinquent until the 181st day. The FCC will not report (on an SF220-9) auction loan delinquencies to Treasury until after the 180th day has lapsed. OMD will work with OGC to determine the "181 day" within the payment rules. The FCC will insure that the entire amount of delinquent debt is consistently reported in the future, regardless of the status of the debt or the potential value from any auction of the spectrum previously associated with the defaulted license. The aging of debt in bankruptcy and whether such debt should be reported in Part 1 (Status of Receivables), Section B (Delinquent Debt by Age) of SF 220-9 remains to be clarified.

4. Section A: Delinquent Debt 180 days or less

Recommendation: The FCC should not report any loan amounts as being between 1 and 180 days delinquent. Installment payment rules provide for two automatic 90-day grace periods. Treasury does not consider a loan delinquent until the end of any contractually provided grace period. This section should report all zero's unless current install payment rules change.

Response: **Concur.** It should be noted that the two 90-day grace periods, combined, may exceed 180 days due to the FCC's rules for calculating time periods that end on a Saturday, Sunday or holiday. The FCC will not report auction loans as delinquent 180 days or less, as long as the current installment payment rules remain in effect.

5. Section B: Delinquent Debt 181 days or over

Recommendation: The FCC should not be reporting that any of its debt is eligible for referral to Treasury because it does not appear to fit the criteria for referral under the DCIA. The delinquent debt is either tied up in bankruptcy or the Commission expects to apply proceeds against the outstanding debt from the amounts garnered at a subsequent auction.

Response: **Concur,** because, at the time this report was written the FCC did not have any auction loan debt to refer to Treasury. However, since that time, the FCC has had additional auctions and some of the spectrum auctioned is associated with defaulted licenses and licensees in bankruptcy proceedings. For example, Auction No. 22 auctioned new licenses to use spectrum that had been associated with a cancelled license. The FCC is currently confirming whether any of the \$22,131,397 listed in Section B of Part 2 (at page 8 of the Draft Report) includes debt that is eligible for referral to Treasury.

6. Section C: Collections

Recommendation: This section (of the SF 220-9) should be completed to reflect that the amount in bankruptcy is in litigation, and the outstanding amount awaiting application of proceeds from a subsequent auction should be listed as "other". The FCC should footnote the specific collection actions being taken at the agency (i.e. borrower notification of default, reauction).

Response: Concur.

7. Section D: Debt Disposition

Recommendation: The FCC has not written off any debt determined to be uncollectible, thus this section (of the SF 220-9) is currently not used by the FCC. Should the Commission decide to write-off any delinquent debt, the number and dollar amount of receivables written-off should be reported in this section as either not closed-out (if FCC is still pursuing collection) or reported to the IRS on Form 1099-C.

Response: 7. Concur, but there is an open question as to whether some portion of the restructured C block debt should have been treated as written off/uncollectible. This issue is being pursued with the OGC, Treasury, and OMB to determine the proper recordation of the amounts.

PART 3: FOOTNOTES

Recommendation: We suggest the FCC consider including footnotes for the following items on future SF 220-9 reports.

- a. brief summary of installment rules that cause no loans to be classified as delinquent.
- b. Brief summary of debt collection actions being performed by the FCC under Part 2, Section C.

Response: Concur. To the extent possible a footnote incorporating the two additional notes will be added to the SF 220-9.

"Responses to "Debt Management Observations and Recommendations"

1. Portfolio Performance Reporting

Recommendation: An important aspect of the loan servicing function is monitoring the portfolio and related transactions. This is often accomplished through reviewing portfolio reports on a regular basis, such as monthly. Currently, there are no monthly portfolio performance or tracking reports being reviewed by the loan servicing personnel of the FCC for debt collection purposes. These reports, many of which can be generated from the Nortridge system, should be prepared and reviewed on a regularly scheduled basis. Officials from the Wireless Telecommunications Bureau and the Financial Operations Division (the two chief parties responsible for loan servicing and debt collections) should conduct a status meeting, at a minimum of once a month, to discuss the reports, performance issues, and collection strategies.

Response: Concur. Since January 23, 1999 the CFO has held weekly meetings with the staff of each office involved to resolve issues associated with the management of the portfolio. Additionally, CDMC and WTB staffs meet, again, once a week, to review detailed issues associated with individual loan performance. Once a month, FO and WTB staff compare payment notes and generate statements to loan holders. Nortridge is currently used only to track payments and the reports from Nortridge do not accurately reflect payment applications rules and delinquencies. In January the RAMIS system portfolio system will be implemented. Additional detailed reports will be available at that time. Once the loan system improvements are implemented, routine monthly meetings will be initiated. Until then, we will continue the weekly meetings.

2. Demand Letters

Recommendation: With increased reporting and monitoring of the performance of the installment loan portfolio, demand letters should be issued with the same regularity as billing statements. Demand letters should notify the borrower that they are past due, that applicable late fees will be charged, and that payment must be received by a certain date or additionally penalties will be applied. At major milestones in the "non-delinquency" periods (such as 90-days past due, 120 days past due, and just before 180-days past due) efforts should be made, such as a telephone call, to inform the borrower of the seriousness of their delinquency, and the pending cancellation of their license if payment is not received by the 180th day.

Response: Concur. New loan portfolio management software scheduled for implementation early in 2000 will help us implement this process. The process will be fully integrated into contract solicitation for an outside loan servicer that is underdevelopment and expected to be in place by March, 2000.

3. Front End Controls

Recommendation: Consistent with guidance from OMB regarding credit applicant screening, the FCC should consider independently verifying the information provided by loan applicants. The FCC should also make an independent determination of the applicant's ability to repay the loan, as well as a satisfactory history of repaying debt. Credit reports and supplementary data sources, such as financial statements and tax returns, should be used to verify or determine revenue, held assets, credit history, and financial viability.

Response: 3. This issue remains to be resolved and the recommendation fails to take into consideration the tension between using the devices suggested for assessing creditworthiness and the installment program's goals of providing opportunities to start-up companies with few assets and limited revenues. The Commission did consider the type and degree of front-end controls that should be employed in granting licenses on an installment payment basis and decided to rely on applicant certifications and upfront and down payments as the principal mechanisms for increasing the likelihood of repayment. The Commission declined to order applicants to provide, on a routine basis, detailed evidence of their ability to repay, and declined to devote agency resources to conducting routine, independent investigations of applicants' creditworthiness. Moreover, the Commission, less than a year ago, endorsed a certification approach toward underwriting in the context of license/debt assignments. *See In re Applications for Assignment of Broadband Personal Communications Services Licenses for Station KNL457, et al., Order*, 14 FCC Rcd 1124 (1998) (balancing regulatory responsibilities against creditor concerns in deciding to endorse use of an Assignment and Assumption Agreement that relied solely on assignee certification of solvency as mechanism for ensuring creditworthiness).

Given the more recent discussions about the applicability of provisions of DCIA, OMD will continue to investigate the implementation of front-end controls on current license transfers and the need for the Commission to rule on this issue.

4. Private Section Financing

Recommendation: If the FCC decides to continue the installment loan program, it should consider implementing some mechanism, in addition to the down payment requirement, to ensure that businesses granted spectrum licenses are able to fulfill their financial commitment to the FCC. From the limited history of the installment loan program to date, it appears that one of the leading causes of default by licensees is the inability to raise sufficient capital to cover their obligation to the FCC and build-out their systems. There is a built-in lag time in the regulatory process between the end of an auction and the grant of licenses to the winners. During this period, participants in the marketplace have the opportunity to petition the FCC to deny the granting of the license to the winning licensee. The Commission, for example, might consider using this time to allow licensees in the installment loan program to secure private financing as a prerequisite for the licenses being granted.

Response: Concur that should the FCC decide to re-institute the loan program, the Commission should consider rules (other than self certification) that would require a licensee to secure private sector financing before they are granted a license.

5. Asset Sales

Recommendation: The FCC should study the possibility of asset sales of delinquent debt. A less costly alternative to servicing and collecting on delinquent debt may be to focus efforts on clearing the legal and regulatory obstacles to selling delinquent installment loans instead of contending with expensive bankruptcy cases and servicing other delinquent loans.

Response: Concur. The Commission analyzed the sale of performing and delinquent debt in internal memoranda during 1997. The memoranda highlighted numerous issues related to the sale of debt including: questions about the Commission's statutory authority to sell performing debt; the ability of a debt holder to hold a security interest in the license; and, whether the sale of the loans would harm aspects of 309(j), particularly designated entity rules. This analysis did not include a loan by loan analysis of the portfolio and was concluded prior to the recent bankruptcy rulings that affect the value of the portfolio. While funds have not been budgeted to undertake such a review, OMD and WTB staff will revisit the possibility of the sale of all or some portion of the portfolio once the bankruptcy issues have been resolved.

6. Gather Borrower Credit Information

Recommendation: Collecting debtor financial and credit information is critical in order to consider repayment and compromise offers. It is difficult to adequately consider restructure/collection strategies if the FCC does not have a complete understanding of the financial condition of its borrower(s). The Commission should gather financial information on its borrowers, such as financial statements, credit reports, tax returns, etc. to understand and verify the financial condition of its borrowers and as a step in monitoring the performance of this portfolio.

Response: Concur. When a licensee-debtor seeks to compromise its debt (only one has occurred to date), the FCC does require the submission of comprehensive financial and credit information, as part of the review and evaluative process set forth in the Debt Collection Improvement Act and associated regulations. Nevertheless, the precise methodology for eliciting and evaluating such financial/credit information is evolving. Staff from WTB and OMD (with guidance from OGC) have begun to construct such a methodology, by tapping the expertise of the Department of Justice and agencies with loan portfolios. Staff will propose that the Commission initiate a rulemaking proceeding or adopt a policy that would clarify the specifics of the agency's approach toward loan workouts (including, but not limited to, the agency's requirements for submitting financial/credit information in connection with debt compromise requests).

7. Procedures for Transfer of Installment Debt to Treasury

Recommendation: Treasury officials have stated that the FCC is not required to transfer its debt to Treasury. This is a result of 1) the commission expects to apply proceeds against the outstanding debt from the amounts garnered at a subsequent auction, and 2) a large portion of the portfolio is in bankruptcy. However, the FCC should have procedures in place that illustrate how to document, certify, and transfer its loans to Treasury, so that when the current obstacles to referral have been cleared the Commission will know exactly what needs to be performed. The FCC should also define procedures for writing off loans returned by Treasury as uncollectible. Given the unique nature of the Spectrum Auction installment loan portfolio, the FCC should get a memorandum of understanding from Treasury regarding the applicability of transfer requirements and formalize specific criteria for referral of delinquent FCC installment debt to Treasury.

Response: Concur. The profile form for auction debts has already been added to the current procedures for referral of debts to Treasury. When current obstacles clear, the FCC will be in position to transfer outstanding debts to Treasury. Unwritten procedures have been established for uncollectible debts returned to the agency and will be documented in the near future. The Deputy CFO has been assigned responsibility to document and compile all unwritten procedures into an FO procedures manual.

8. Procedures for Accounting for Return of Defaulted Licenses

Recommendation: FASAB2 requires when property is transferred from borrowers to a Federal credit program through foreclosure or other means, in partial or full settlement of post-1991 direct loans, the property is recognized as an asset at the present value of its estimated future net cash inflows discounted at the original discount rate. When the FCC cancels a license, it will need to value the asset for accounting purposes. Accordingly, the FCC should establish accounting policy to handle the cancellation of licenses from borrowers in default.

Response: Concur that a policy to handle the valuation should be adopted; however, the Report's recommendation to adopt an accounting policy for valuing licenses upon license cancellation is problematic. Accordingly, we have adopted a policy that any valuation of licenses will be postponed until the Commission conducts an auction of a new license to use the spectrum associated with a cancelled license. The defaulted debt will remain on the agency books at full value until a subsequent auction allows for the calculation of a new value with a reasonable degree of certainty.

9. Loan Files

Recommendation: The FCC will need to ensure that all pertinent loan documents are located. If the FCC is unable to locate such information, the FCC may want to consider recreating the information. The FCC should adopt a formal policy and written procedures

based on the current loan file checklist for the creation and its loan files.

Response: Concur. Efforts were initiated in February 1999 to ensure that all loan documents are located and filed under appropriate controls. Members of OMD and WTB meet weekly to resolve outstanding file issues. The incomplete loan files are now valued at less than 3% of the value of the total portfolio.

10. Loan Servicing Responsibilities

Recommendation: Loan servicing responsibilities for the Spectrum Auction installment loan portfolio have recently been transferred from Financial Management Services in Birmingham to the Credit and Debt Management Center at the FCC. However, the FCC has stated previously in Commission documents that it does not have the resources or the expertise to function effectively as a creditor. If this is the case, the FCC should contract loan-servicing responsibilities to a private contractor who has the financial resources and financial incentive to maximize collections to the Commission. The FCC is currently interviewing third party loan servicing contractors. The Commission should take action to move loan-servicing responsibilities to one of these contractors as quickly as possible.

Response: Concur. The public accounting firm of Arthur Andersen has performing a cost-benefit analysis and a requirement study to determine the FCC best course of action. The results of this study, which have been shared with the OIG and WTB, recommend outsourcing the function but maintaining a key number of FCC staff assigned to coordinate the efforts of the contractors and additional OIG staff to audit the efforts.

11. Inter-Bureau Communication

Recommendation: The Chief Financial Officer (CFO) of the FCC or a member of the CFO staff should always be given the opportunity to participate in any meetings or discussions related to the spectrum auction program. This would include the consideration of any repayment or compromise offer. It is important to include personnel of the Commission who are responsible for servicing, accounting, and reporting on spectrum licenses and loan receivables.

Response: Concur. Inter-Bureau communications have shown significant improvement. OMD has begun a significant training program for OMD, MMB, OGC and WTB and other FCC employees on Credit Reporting issues. This training has been designed to raise the awareness among all agency staff of the complex requirements of the CDIA and other statutes and to provide OMD - FO staff the working knowledge needed to assist Bureaus and Offices in the resolution of credit issues in the future. CDMC, WTB and OGC are committed to strengthening communications line open.

ATTACHMENT B

A. Overview of Delinquent Debt and Debt Management Activities

1. Page 6 -- The first sentence of the first full paragraph is inaccurate. Change it to read as follows: "The C block auction closed *about six months before* the drop (*during winter of 1996*) in telecommunications company stock prices.
2. Page 19 -- The description of disaggregation under the heading "3. Disaggregation" is inaccurate. Replace the forth sentence with the following: "*In receiving forgiveness of 50% of the outstanding debt, the licensee retains the benefit of 50% of the original down payment. In addition, 40% of the down payment associated with the disaggregated spectrum that was returned to the Commission (or 20% of the original down payment) would be used to prepay Suspension . . .*" Also, change the last sentence of the disaggregation description to read as follows: "*This credit represents 70% of the down payment associated with the 15 MHz returned spectrum (or 35% of the original down payment), plus 100% of the down payment associated with the 15 MHz of retained spectrum (or 50% of the original down payment).*"
3. Page 20, Number 2 in the list of three categories of debt that is over 180 days past due (9 lines from bottom of page) -- Revise the phrase as follows: "2. defaulted debt not in bankruptcy; borrower should be notified of default; and *new license for same spectrum* [/ auctioned to satisfy debt."

B. Overview of Approaches for Determining Collectibility of Spectrum Auction Loan Portfolio

1. Page 9, 1st full paragraph, 6th line -- Delete the word "adversely," so the extended phrase would now read, "estimated rates may affect the position of the FCC . . ."
2. Page 9, 3rd and 4th sentences after the "Bankruptcy" heading -- Modify these sentences to read as follows: "The Commission is currently seeking assistance from Congress to clarify that FCC licensees who default on their installment payments may not use bankruptcy litigation to avoid *the automatic cancellation of* their spectrum licenses. A number of FCC licensees have argued that, even if they default on their installment payments the licenses do not automatically cancel and the Commission cannot *auction new licenses for the same spectrum* while bankruptcy litigation is pending."
3. Page 9, last sentence -- Modify the sentence, as follows: "In the absence of clarifying legislation, there is a risk that valuable spectrum licenses will be tied up in litigation, delaying the cancellation *of the debtors' licenses* and subsequent auction of *new* licenses, the introduction of new services and competition, and the collection of revenues."

4. Page 10, first sentence -- change the last word of the sentence from "auction" to "*licensing*."
5. Page 15 -- In the discussion of NextWave (in the bottom half of the page), the remaining obligation figure is wrong. It should be **\$549** million. (The incorrect figure of \$881 million appears twice on the page.) Also, the introductory sentence to the indented text should refer to "*four*" possible outcomes, not three.
6. Page 16, indented paragraphs "3" and "4" -- The original obligation figure is wrong. It should be "approximately **\$4.7** billion," not \$4.3 billion. (The incorrect figure appears in two places.)
7. Page 16, last paragraph, first sentence -- Given the inclusion in the scenarios of a full repayment under the original terms by NextWave, this sentence should state, "The likely recovery on these loans could potentially range between 20% and **100%**, depending on the outcome of the pending bankruptcy litigation."
8. Page 16, last paragraph -- The proposed methodology for determining a weighted recovery value for the loans in bankruptcy won't work, because it depends on counsel "assign[ing] a reasonable probability of occurrence to each potential outcome." Such an exercise may compromise both the government's position in litigation and the confidentiality of attorney-client communications. See "Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information" (ABA, Dec. 1975) ("In view of the inherent uncertainties, the lawyer should normally refrain from expressing judgments as to outcome except in those relatively few clear cases where it appears to the lawyer that an unfavorable outcome is either 'probable' or 'remote'.").

C. Performance Review Guide Results to Date

1. Page 5, 3rd full paragraph -- Revise the first sentence to read: "The C block auction closed *about six months before* the drop (*during winter of 1996*) in telecommunications company stock prices."
2. Page 9, section "e." -- If granting "compromise authority" means agreeing to compromise a debt, then the Commission has done that (with DOJ approval) both on a global basis (for C Block licensees) and on an individualized basis (in the case of Anishnabe). The Anishnabe compromise, however, was not granted until after the draft date of the Accountants' draft Reports, although the compromise request was under consideration prior to that date.

3. Pages 10-11, Number "3. Disaggregation" -- The description of disaggregation should be corrected as indicated above in C-2. Thus, replace the forth sentence with the following: *"In receiving forgiveness of 50% of the outstanding debt, the licensee retains the benefit of 50% of the original down payment. In addition, 40% of the down payment associated with the disaggregated spectrum that was returned to the Commission (or 20% of the original down payment) would be used to prepay Suspension . . ."* Also, change the last sentence of the disaggregation description (on p. 11) to read as follows: *"This credit represents 70% of the down payment associated with the 15 MHz returned spectrum (or 35% of the original down payment), plus 100% of the down payment associated with the 15 MHz of retained spectrum (or 50% of the original down payment)."*
4. Page 11, 1st full paragraph -- Revise the last sentence to read as follows: "Licensees, who believed the three options offered by the Commission did not provide sufficient financial relief, could file for bankruptcy *in an effort to* restructur[e] their business and protect[] their assets."
5. Page 11, 2d paragraph from bottom -- Revise the last sentence to read: "In addition, since *certain licensees are seeking to use* bankruptcy as a fourth restructuring option, it is . . ."
6. Page 12, 1st paragraph -- This paragraph incorrectly concludes that all the licensees who filed for bankruptcy did not believe that the restructuring options were adequate. One of the largest bankrupt licensees -- DCR PCS -- however, did in fact endorse these options as an appropriate restructuring approach. The fact that it filed for bankruptcy is irrelevant, because it filed before the restructuring options were adopted. Thereafter, during the course of its bankruptcy, DCR PCS elected one of these options, and the bankruptcy court has permitted the election to go into effect. In recognition of these facts, the statistics cited in this paragraph should be adjusted accordingly. For example, the assertion that "borrowers that represented at least 75% of the outstanding balance did not [believe that the restructuring options were adequate]" should be revised to exclude DCR PCS, rendering the phrase as follows: "borrowers that represented 60% of the outstanding balance did not."
7. Page 12, 2nd paragraph -- The first sentence is a little misleading. DCR PCS filed for bankruptcy before the Commission issued any ruling on the restructuring options, while GWI filed immediately after the principal ruling but before the Commission issued a reconsideration the decision (which slightly modified the principal ruling).
8. Page 28, 1st paragraph in chart no. 6, following the arrow bullet entries -- The last sentence should be revised as follows: "The FCC management indicated it does not currently *perform valuations of* spectrum licenses because this is the job of the marketplace, and pronouncements in advance of an auction may skew the auction results. *Moreover, FCC management has expressed concerns that a valuation done outside the crucible of litigation may affect the* pending bankruptcy cases."

9. Page 28, 2nd paragraph under "Observations" in the chart following "b." -- Correct the last sentence of the paragraph to read: "In the bankruptcy case regarding GWI, the court ruled that the value of *certain licenses in the C block* as of January 1997 was worth only 16 cents on the dollar."
10. Page 28, Second to last sentence on page -- Revise the sentence, as follows: "Weighing these and other factors, the Commission decided to suspend the installment loan program (*i.e., it decided to stop offering an installment payment option when auctioning new licenses*)."
11. Page 30, 1st paragraph under "Observations" in the chart following "c." -- Revise the end of the second sentence to read as follows: "... and, should those conditions not be met, the licenses automatically *cancel*." Also, revise the ending of the last sentence of the paragraph to read: "... that FCC licensees who default on their installment payments may not use bankruptcy litigation to *avoid such automatic cancellation*."
12. Page 30, last paragraph under "Observations" in the chart following "c." The last clause of the second sentence should read: "... , a debtor cannot *retain* the license without satisfying its full obligation."